PROPOSED POSTAL RATE INCREASES

HEARING

BEFORE THE

SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE, AND GENERAL SERVICES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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CONTENTS

Opening statements: Page

Senator Stevens 1
Senator Pryor 13

WITNESSES

THURSDAY, FEBRUARY 19, 1981

A. Lee Fritschler, Chairman, Postal Rate Commission, accompanied by Simeon M. Bright, Vice Chairman; Commissioners James H. Duffy, Clyde S. DuPont, and Janet D. Steiger 6

Alphabetical list of witnesses:

Bright, Simeon M.: Testimony 6
Duffy, James H.: Testimony 6
DuPont, Clyde S.: Testimony 6
Fritschler, A. Lee: 6
Introduction and summary to Postal Rate Commission opinion and recommended decision in docket No. R80-1 3
Testimony 6
Adjustments to USPS proposed revenue requirements (chart) 9
Summary of USPS proposed and PRC recommended rate increases (chart) 12
Steiger, Janet D.: Testimony 6

Additional material submitted for the record:

Letter to Senator Stevens from Senator Howard Cannon, Mar. 2, 1981 33
Joint concurring opinion of Mr. Fritschler, Mr. Bright, Mr. DuPont, and Mrs. Steiger 34
Dissenting opinion of Mr. Duffy 43

PROPOSED POSTAL RATE INCREASES

THURSDAY, FEBRUARY 19, 1981

U.S. SENATE,
SUBCOMMITTEE ON CIVIL SERVICE,
POST OFFICE, AND GENERAL SERVICES,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 8 a.m., in room 1318, Dirksen Senate Office Building, Senator Ted Stevens (chairman of the subcommittee) presiding.

Present: Senator Stevens and Senator Pryor.

Staff present: Wayne Schley, staff director; Pat Halcomb, chief clerk; Jamie Cowen, chief counsel; John Rixey; Merry Halamandaris; and Knox Walkup, minority staff director.

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Good morning. This is the first of a series of hearings before this subcommittee, which now has jurisdiction over the U.S. Postal Service. On Tuesday, February 24, we will hold the initial hearing on the question of the implementation of the nine-digit ZIP code, called "ZIP + 4". That hearing will also begin at 8 a.m. and will be in room 3302.

It is my intention to commence these hearings at 8 a.m. and have them over by 10:30 a.m., because many of us have other subcommittees and we must be able to have additional time. I hope, since we do have jurisdiction over matters which effect the Government, that most of our witnesses will be employees of the Government and that there will be general agreement that this is an acceptable procedure.

This morning we are pleased to have with us the members of the Postal Rate Commission. The purpose of this hearing is twofold. The first is to focus attention on the ratemaking process.

Since the Postal Reorganization Act of 1970, the establishment of postal rates has been in the hands of the Rate Commission with final approval by the Board of Governors of the U.S. Postal Service. Too often, Congress is still thought to be in the postal ratesetting business. That is not the case. Short of increasing Federal funding to the U.S. Postal Service, Congress does not set or influence postal rates.

The second purpose is to hear the actual recommendation by the Rate Commission on the extent postal rates should increase in the opinion of the Commission.

These are unusual hearings, unusual in the sense that never before has the Rate Commission appeared before a congressional committee to announce its rate case decision. We felt it important

that the Commission appear here so that we could review the postal ratemaking procedure and hear the Commission announce its decision on the U.S. Postal Service's request for a postal rate increase of 5 cents per first-class stamp, or a 33-percent increase, and lesser amounts for other classes of mail.

I think that these unusual hearings are consistent with the times, which call for unprecedented action. Last night we heard the President explain the necessity of getting the country's economy back on track and the steps he proposes to accomplish that goal. The Postal Service was not spared from that effort, as we all know. A postal rate increase, regardless of its amount, will unfortunately have an inflationary impact on the economy. Nevertheless, some additional funds are needed.

In January of 1976 a first-class stamp cost the sender 13 cents. Ninety percent of the first-class mail sent outside the local area arrived at its destination 2 or 3 days later, depending upon how far the letter had to travel. Today that stamp costs 15 cents and we will hear in a few moments the amount of increase that the Commission will recommend.

Despite increases in postage, service has suffered. Today slightly over 85 percent of the first-class mail sent outside of the local area will arrive at its destination on time. That is a decrease of 5 percent in 4 years. This is more startling when one considers that from 1973 to 1976 delivery performances for nonlocal mail rose from 80 to 90 percent.

The rate case before the Commission commenced 10 months ago in April 1980. Its announcement was overshadowed by the heat of the Presidential primary campaign. An issue in that campaign was the high inflation rate. According to the Postmaster General, the need for the postage hike is caused by inflation.

Again, going back to January 1976, we have seen an increase of 55 percent caused by inflation. This fantastic spiral has had a negative influence on us all, and the Postal Service is no exception. According to the Postmaster General, if inflation had remained steady these past 2 years rather than rising, the Postal Service would not have had to request an increase for at least another year.

This postal rate case is extremely important, being announced 1 day after the President's message to the American people on the need to tighten our belts and to do everything possible to hold costs down. Yet, lacking an increase in Federal funds, the Postal Service obviously needs the revenue that will come from increased rates.

The rate must not be too high, or it will fan the flame of inflation, yet it must provide enough revenue to allow the Postal Service to carry out its essential function.

In addition, the rates must allow the Postal Service to be competitive. I do not need to remind any one here that, even with regard to letter mail, the Postal Service must compete with other modes of communication.

Let me assure the members of the Commission that this hearing was not called in any way to embarrass you. I am delighted that you agreed to come and give us the results of your deliberations.

I congratulate you on getting this case to this point within the period of time that you did, because it is a decision which is obviously needed by the Postal Service.

We would like to know, Mr. Chairman, what your colleagues have to tell us, not only about the decision itself but about the process of arriving at that decision and the data upon which you relied in making it.

We are delighted to have you here and, again, I appreciate your willingness to come at this hour.

Mr. FRITSCHLER. Thank you, Mr. Chairman. It is the best part of the day.

On behalf of my colleagues, I would like to thank you for the opportunity to appear.

I have submitted to the committee the introduction and summary sections of the opinion, which will be my formal statement and the formal statement of the majority of the Commission. I also have an oral statement with which I would like to proceed at this time.

Senator STEVENS. Without objection, the sections of the opinion which you have submitted will be included in the hearing record at this point.

[The information referred to follows:]

INTRODUCTION AND SUMMARY TO POSTAL RATE COMMISSION OPINION AND RECOMMENDED DECISION IN DOCKET NO. R80-1 (ISSUED FEBRUARY 19, 1981)

The Commission has before it the fifth general rate increase request filed by the Postal Service under § 3622 [1] of the Postal Reorganization Act of 1970. Deciding a general rate case in the statutory time allowed is commonly a challenging task, but this case has presented more than the usual quantum of difficulties. Some of these have been inherent in analyzing the largest revenue increase yet proposed; others, unfortunately, stem from the approaches to the case taken by some of the principal parties.

In particular, we have been asked to consider proposals that plainly imply a drastic retrogression in postal costing. The ratemaking methods we have developed—with valuable contributions from many participants in previous cases and, especially, with judicial guidance—have been treated in some of the presentations made here by parties in the proceeding as little more than historical curiosities. In particular, the Postal Service has invited us to reduce drastically the level of cost attribution and to abandon the most significant step taken toward the reasonable assignment of nonattributable costs. The Officer of the Commission (OOC), while presenting the only alternative case covering all the classes of mail, has proposed an even larger step backward, invoking costing principles long since rejected by the Commission and dependent to an unacceptable degree on subjective judgments. We reject both of these approaches. It is fortunate that the four rate proceedings already decided by us, and the three comprehensive and instructive opinions [2] issued by the U.S. Court of Appeals for the District of Columbia Circuit have defined the general principles required by the Act sufficiently clearly to permit us to arrive, on the present record, at a decision which maintains the necessary cost tracing [3] at an appropriate level and otherwise complies with the requirements of the law.

Among the most important points in this decision are changes we have found necessary in the Postal Service's proposed revenue requirement—conceptually the

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[1] Statutory section numbers appearing alone may be taken as referring to title 39, United States Code, unless the context indicates otherwise.

[2] National Association of Greeting Card Publishers v. USPS [NAGCP III], 607 F.2d 392 (D.C. Cir. 1979), cert. denied, 444 U.S. 1025 (1980); National Association of Greeting Card Publishers v. USPS [NAGCP I], 569 F.2d 570 (D.C. Cir. 1976), vacated as to other issues, 434 U.S. 884 (1977); Association of American Publishers, Inc. v. Governors of USPS [AAP], 485 F.2d 768 (D.C. Cir. 1973).

[3] We will occasionally use the term "cost tracing" to cover both attribution and reasonable assignment—that is, the process, in its most general form, of associating cost elements with classes of mail on the basis of causational inferences.

first issue to be resolved in any rate proceeding, and the basis from which first costing, and then pricing, must start. We have made the largest adjustments in the revenue requirement to have been found necessary in any rate proceeding. The Postal Service has requested rates which would generate a $3.75 billion (20 percent) increase in its total revenues. This would raise its revenue to $23 billion in the March 1981-March 1982 test year. We have reduced the request by slightly over $1 billion. We have done so by:

Promoting the fiscal responsibility goals of the Act by eliminating, for this case, the revenue requirement item of $449 million for prior years' losses. The Postal Service has in fact not used allowances for past losses provided by us in prior cases to retire or reduce its cumulative deficit of over $4 billion—a situation demonstrated on this record by its declared policy of promoting "rate stability" by delaying rate adjustments to the prejudice of the break-even requirement of the statute;

Making a careful assessment of real, as opposed to nominal, productivity increases, so that the $143 million in savings actually achieved can benefit the mail-using public;

Determining a realistic 10 percent discount rate, based on actual investment returns, to be applied to workers' compensation accruals, resulting in a downward adjustment of $327 million; and

Eliminating $385 million of overestimates in the Service's computations of its claimed contingency allowance and Civil Service retirement fund liabilities.

We have also restored funds to the revenue requirement where necessary, by:

Adding $144 million to correct Postal Service underestimates of cost of living adjustment (COLA) costs in the test year; and

Adding $99 million by correcting a technical error in the Service's calculation of costs for third-class mail.

The Commission's reduction in the revenue requirement will be a prime cause of lower rates, which in turn will elicit an estimated 2.1 billion additional pieces of mail.

In our treatment of the revenue requirement, we have departed from some of our past approaches because the parties have advanced cogent reasons for doing so. In the costing area, we have also been asked to depart from precedent, but convincing reasons have not been offered.

We said above that both the Service and the OOC urged us to backtrack substantially in our costing procedures. The result of the Postal Service's proposals would be to cut substantially the proportion of costs we are able to trace, on inferences of causation, to classes of mail and to increase correspondingly the residue of costs available for judgmental allocation using noncost factors. The Commission attributed and assigned 74.5 percent of the revenue requirement in the last rate proceeding; the Service would have us reduce this level to 59.3 percent. While there are a few areas in which genuinely new data result in a finding that small reductions in attribution levels must be made, the Service has for the most part advanced no acceptable reasons for this retrogression in attribution and assignment. In particular, it has urged us to abandon the service-related cost theory developed, and judicially approved, in the last case. Its reasons for doing so are singularly unconvincing. The result of this proposal, were we to adopt it, would be to reduce the proportion of costs reasonably assigned from 10.4 percent to only 1.8 percent in this decision.

The OOC, on the other hand, cannot be charged with seeking to reduce the levels of cost tracing (though he does concur with the Service in jettisoning service-related costs). The levels of attribution and assignment proposed by the OOC are unquestionably high; the difficulty is that he has reached them by abandoning the progress made in ten years of postal ratemaking toward a substantially causation-based costing process which accounts for the bulk of the Service's revenue requirement, and proposed instead to revive a theory the Commission rejected as long ago as 1975. His theory is defective because it asserts causal relations between the costs of activities and the classes of mail, with no cogent support. The shortcoming in this approach is that it ignores, in effect, any goal other than maximization of cost tracing. The court has made it plain in two decision[1]—but especially in NAGCP III—that the law requires not merely a high level of cost tracing but rather meaningful progress along the lines laid down in our past decisions toward a

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[1] The suggestion made in a few pleadings—*e.g.*, MPA Initial Brief, pp. 10-14—that we simply ignore the decisions of the Court of Appeals in *NAGCP I* and *NAGCP III* on the grounds that another Circuit might arrive at a different result strikes us as irresponsible. We recognize that government agencies have on occasion acted in this way, but we find ourselves in agreement with Judge Weis (concurring in Goodman's Furniture Co. v. U.S. Postal Service, 561 F.2d 462, 465-466 (3rd Cir. 1977) and Judge Lay (concurring in May Department Stores Co. v. Williamson, 549 F.2d 1147, 1149-1150 (8th Cir. 1977) as to the desirability of the practice.

minimization of the costs that must be allocated on noncausal grounds. The OOC's theory would allow us to reach an attribution/assignment level of 74.2 percent, but only at the price of arbitrary and judgmental pigeonholing of cost elements. Instead—following proven methods of attribution and assignment—we have reached 73.6 percent.

We have, then, determined to follow, and improve, our established costing practices. We have restored service-related costs to what we consider their proper place in the process at this stage in the development of postal costing. In doing so, we have been mindful that an administrative agency is not inextricably bound to precedent; but we have concluded that the reasons advanced for abandoning our previous approach are at best insubstantial. The result of this decision on our part is that we maintain the level of cost tracing attained in Docket No. R77-1. We had hoped, as did the court which reviewed that decision, that it would be raised. We still hope that in future cases the parties will not devote resources to efforts like those made here to turn back the clock, but instead will accept the existing framework of postal costing and join with us in seeking to refine it.

The rates we recommend in this decision are different in a number of ways from those proposed by the Service. In particular, we have:

Recommended first-class letter rates (single piece) of 18 cents for the first ounce and 17 cents for additional ounces;

Recommended an "intra-BMC" discount of 14 cents per piece for parcel post mailed and delivered within a single Bulk Mail Center area, recognizing savings from elimination of additional BMC handlings;

Further refined the parcel post structure so that the extra costs caused by many nonmachinable parcels are recovered through a 50-cent surcharge on nonmachinable parcels passing between two BMCs;

Retained the distinction—already accepted by the Postal Service Governors—between expedited and regular second-class service and recommended a cost-based rate differential whereby expedited rates are 2.4 cents higher than they would be absent the distinction, and regular rates 1 cent lower;

Recommended presort discounts for some categories of second-class mail that have not previously enjoyed them; and

Generally moderated the increases sought by the Postal Service, as shown by the following table:

COMPARISON OF USPS PROPOSED AND PRC RECOMMENDED RATE INCREASES

[Based on average revenue per piece]

	Percent rate increases	
	USPS	PRC
First class:		
Letters and sealed parcels	33	21
Post/postal cards	32	22
Priority	32	27
Express mail	15	13
Second class:		
Within county	−15	6
Regular rate (combined ordinary and expedited)	2	9
Nonprofit	−6	6
Third class:		
Bulk regular	18	9
Bulk nonprofit	−6	8
Fourth class:		
Parcel post	11	13
Bound printed matter	0	−4
Special rate	1	5
Special services	13	12

In other areas, the Commission has continued to pursue improvements in joint mailer-Postal Service productivity by adopting the Service's first-class carrier route presort proposal, making the changes in second-class discounts already mentioned, and refining third-class presort discounts better to reflect actual cost savings to the Service.

The large volume of testimony and exhibits in this case—running to some 20,846 pages of transcript and representing the efforts of 91 witnesses who appeared in 58

days of hearings—is a sign of the importance the Service, the OOC and the 42 intervenors have attached to all aspects of this complex proceeding. For our part, we have made strenuous efforts—we think, successfully—to consider every proposition advanced on the record while still rendering this decision within the statutory 10 months.

One matter, more procedural than substantive, deserves passing mention. This docket has demonstrated the great potential of computer-assisted presentation and analysis. As is perhaps inevitable when novel methods are used, the Service's employment of computer materials has generated considerable procedural controversy. That controversy has been satisfactorily resolved in this docket, though at some cost in time and litigation resources. We hope, in the near future, to provide by rulemaking a more predictable framework for the presentation of computer materials which will simultaneously advance the decisionmaking process and protect the rights both of the parties who have developed the materials and of the other parties who may wish to challenge or use them.

The Opinion which follows is arranged in the manner now usual in Commission rate decisions: We discuss the revenue requirement first; then the costing process; and finally the rate design for individual classes and services. The Recommended Decision follows. Volume II contains several technical appendices. One new feature of this decision should be mentioned, however. The Commission has produced a lengthy computer printout, supplementary to Appendix E, showing the application of the Commission's development of a cost forecasting model which replicates the Service's cost outputs and calculates the Commission's costs. We are not distributing these printouts although they form part of the record in this case. Several copies of the printouts will be available for public inspection in the Commission's Docket Room, and copies may be purchased for the cost of reproduction. We are also placing in the Commission's Docket Room a document entitled "Documentation for USPS Attributable Cost Model Software," prepared by a Commission contractor, which is an explanatory description of the operation of the Service's roll-forward cost model. This "user's manual" is not part of our decisional record, since we did not rely upon it ourselves but rather had it produced to assist the parties in the future.

Finally, we have concluded—in part because of matters that have become clear through these proceedings—that two major classification changes need to be thoroughly explored. The proposal for an "intra-SCF" subclass of second class, advocated by Reader's Digest Association in these proceedings, deserves analysis on a complete record. Likewise, it is now clear to us that the potential of a "second tier" for first-class single-piece letters—offering less expeditious service and correspondingly lower rates—must be analyzed. Accordingly, we are contemplating beginning classification proceedings in the near future on both of these subjects.

TESTIMONY OF A. LEE FRITSCHLER, CHAIRMAN, POSTAL RATE COMMISSION, ACCOMPANIED BY SIMEON M. BRIGHT, VICE CHAIRMAN; JAMES H. DUFFY, COMMISSIONER; CLYDE S. DuPONT, COMMISSIONER; AND JANET D. STEIGER, COMMISSIONER

Mr. FRITSCHLER. The Rate Commission had before it the fifth general rate request since the Reorganization Act of 1970. The total revenue requirement in this case was a large one. This was one of the two or three largest rate cases in the United States, and perhaps even in world history.

The Postal Service requested an additional $3.75 billion. This amounted to a 20-percent overall increase in rates including a 33-percent increase in first-class rates, which would have meant a 20-cent stamp.

The total of $23 billion requested by the Postal Service is about 1 percent of the gross national product. Consequently, postal operations have a significant impact on public expenditure, on inflation, and on both the Federal budget and off-budget operations.

The case itself was significant, not only in its scope and impact, but in its complexity. The variety and range of issues in this case were large. There were novel, difficult, sophisticated, and of course

conflicting issues and techniques involved. Competition issues emerged in terms of the potential unfairness to private sector firms in attempting to compete with a large Government organization and in terms of allowing the Postal Service to compete effectively in areas where it appears to be losing ground.

We examined several new concepts, Senator. I would like to throw one of them out at this time as an example. This is a new discount rate for parcels handled at only one bulk mail center. I think this is a good example of the kind of thing we did in the decision and the kind of technical problem which we had to face.

The Postal Service proposed a new intra-BMC rate based on cost avoidance, arguing that if a parcel has to go through only one bulk mail center, the savings should be passed on to the mailer.

However, as you know, Senator, a BMC can be very large. For example, the Seattle area covers a major portion of the Pacific Northwest—I think all of it as a matter of fact. It includes all of your State of Alaska. The USPS proposal was for a separate rate for all intra-BMC parcels which varied by pound but not by distance traveled.

The United Parcel Service, an effective and efficient private sector competitor of the Postal Service which was represented by very able counsel, objected strenuously to the intra-BMC rate idea. UPS stated that some parcels could travel five distance zones without an increase in rates under this scheme and they cited as an example a parcel moving from Monroe, La., to El Paso, Tex., which is a long way.

This would constitute, they claimed, unfair competition since transportation represents a large portion of parcel costs.

Our examination found that both the Service and the UPS positions were correct. There was cost avoidance, yet a nondistance related rate was not proper. We found the following solution: Keep the distance rates for all parcels but for intra-BMC parcels reduce the rate by 14 cents across the board to recognize the cost avoidance.

This was one part of one class of mail which we considered. We examined more than 50 classes and subclasses of mail all told. All of them had to be costed, priced fairly, and priced to avoid cross-subsidization.

As you know, gentlemen, the Commission agreed several years ago that its rate decisions could be done in 10 months. That pledge was subsequently incorporated by amendment into the act. We have met that deadline while maintaining due process for the numerous individuals and groups affected by bulk rates.

As you know, the Commission is required to employ formal, quasi-judicial procedures in the pursuit of its rate decisions. Over 53 parties representing hundreds of organizations and thousands of people participated in this proceeding. The Commission held 58 days of hearings, heard 91 expert witnesses, and built a transcript record of over 21,000 pages.

We made strenuous efforts, and we think successful ones, to consider every proposition advanced on the record while still meeting our 10-month deadline.

This is a decision which demonstrates thoroughness and dispatch. I think, if we may pat ourselves on the back just once this

morning, it stands up well when compared to the work of other public utility regulatory bodies in this country.

Completing a general rate case in the statutory time allowed is commonly a challenging task, but this case has presented more than the usual number of difficulties. These stem in part from approaches to the case taken by some of the principal parties.

In particular, we were asked to consider proposals which plainly implied a drastic step backward in postal costing. The ratemaking methods we have developed with valuable contributions from many participants in past test cases and especially from judicial guidance have been treated in some of the presentations made before us as little more than historical curiosities.

The Postal Service, for example, has invited us to reduce drastically the level of cost attribution and to abandon the most significant steps taken toward the reasonable assignment of nonattributable costs.

The Officer of the Commission, who was charged with representing the interests of the general public, presented the only alternative case covering all classes of mail. He proposed an even larger step backward, invoking costing principles long since rejected by the Commission, and dependent to an unacceptable degree on subjective judgments.

Gentlemen, we rejected both of these approaches outright in this decision.

The result of the Postal Service's proposal would have been to cut substantially the proportion of costs which we are able to trace on inferences of causation to classes of mail and to increase correspondingly the residue of costs available for judgmental allocation using noncost factors. This would have had the effect of increasing first-class rates, since first class bears a large portion of institutional costs.

The Commission attributed 75 percent of total costs in the last rate proceeding. The Service would have had us reduce this level to 59.3 percent.

Although there are a few areas in which new data justify small reductions in attribution levels, the Service for the most part advanced no acceptable reasons for this retrogression in attribution and assignment.

The OOC, on the other hand, could not be charged with seeking to reduce the levels of cost tracing. The levels of attribution and assignment proposed by him are unquestionably high. The difficulty is that he has reached them by abandoning the progress made in 10 years of postal ratemaking. He proposed instead to revive a theory which the Commission rejected long ago, as long ago as 1975.

The shortcoming in his approach is that it ignores in effect any goal other than maximization of cost tracing. The court has made it plain in two decisions, but especially in NAGCP III, that the law requires not merely a high level of cost tracing but rather meaningful progress toward a reduction of the costs which must be allocated on noncausal grounds.

The OOC's theory would allow us to reach an attribution and assignment level of 74.1 percent, but only at the price of arbitrary and judgmental pidgeonholing of cost elements.

Instead, following proven methods of attribution and assignment, we have reached 73.6 percent attribution in this particular case.

I want to emphasize as clearly as I can that the PRC has rejected the OOC's methodology and his proposed rates. The OOC's proposal, with its large unjustified burden on some classes of mail, has had much publicity. We have received thousands of letters about his proposal and I am sure that Congress has received many times that number. The concern in those letters can now be put to rest.

We found it necessary to make significant changes in the Postal Service's proposed revenue requirement. Conceptually, this is the first issue to be resolved in any rate proceeding. It is the basis from which costing and then pricing must start.

We have made the largest adjustments in the revenue requirement to have been found necessary in any postal rate proceeding in history. As a result of making these changes, the Commission was able to recommend an 18-cent first-class stamp as opposed to the 20 cents proposed by the Postal Service, without—and I underline without—overburdening other classes of mail as the OOC would have done.

The Postal Service has requested rates which would generate $3.75 billion in increase, a 20-percent increase, in its total revenues. This would raise its revenues to $23 billion in the year beginning March 1981.

We have reduced the request by slightly over $1 billion.

I would like now to turn to this chart.

[The chart referred to follows:]

ADJUSTMENTS TO USPS PROPOSED REVENUE REQUIREMENTS

[Millions of dollars]

	USPS proposed	PRC recommended	Change
Decreases:			
Recovery of prior year losses	449	0	−449
Workers' compensation discount rate	830	503	−327
Contingency	656	393	−263
Savings from productivity improvement	59	202	−143
Civil service retirement fund liability	220	97	−123
Increases:			
Underestimated COLA		144	+144
Correction of USPS error in estimating third-class cost		99	+99
Total changes			−1,060

Mr. FRITSCHLER. We eliminated an item called recovery of prior year losses for a reduction in the revenue requirement of $449 million.

In the past two cases the Postal Rate Commission, with the approval of the court, allowed prior year loss recovery in the hope that over a period of years the accumulated deficit of the Postal Service would be retired.

In fact, in the past these funds have not been used to recover prior year losses but have instead been used for operating expenses.

When the PRC first approved prior year loss recovery, the Postal Service deficit stood at $1.4 billion. We had hoped that the Service

would eliminate the deficit over 7 years, or by 1983. Instead the accumulated deficit has continued to grow and currently stands at $4 billion.

I think this is a bad situation, one that has to be brought to the attention of the Service and one about which something must be done.

Senator, the PYL item is not just an abstruse accounting principle. It is an actual burden on the ratepayer and it has to be examined very carefully.

We believe that our decision on PYL promotes fiscal responsibility while assuring the Service of funds to operate during the test year and 1 year beyond.

The Postal Service, since reorganization, has been required to break even. The Service should therefore charge rates which cover expenses. Instead, the Service postpones rate filings rather than recouping deficits, using the PYL recovery item for operating expenses.

The result of this procedure is to allow the postponement of needed rate adjustments. It is inconsistent with the break-even requirement of the act. When the break-even requirement is preserved, future ratepayers will not have to shoulder the burden of deficits accumulated in the past.

I want to be as clear as I can on this item because it is an important one and is a controversial one. It is possible that, as a result of this action, especially coupled with the others on this chart, the Postal Service might have to file a rate increase request sooner than it might otherwise have to. By sooner, I mean something in the range of 2 or 3 months earlier than anticipated.

However, we believe that the growth of the postal deficit from $1.4 billion to $4 billion over the past several years requires that this matter be brought to the attention of the Service in strict accounting terms and we also feel that the violation of the act, which requires a break even, has to be faced by the Postal Service.

All this is better than continuing to run up a larger deficit. The revenues in this decision are sufficient for the test year and 1 year beyond, or for the next 2 years.

Senator STEVENS. You do not think that there would have to be a rate increase for 2 more years if your recommendations are followed. Is that right?

Mr. FRITSCHLER. Absolutely, at least 2 more years. The matter of how far beyond 2 years the Service could go depends on four major factors: One is the rate of inflation; two is expenses of the Service; three is productivity; and four is mail volume. I will have more to say on the last point.

At this time, I should emphasize that mail volumes are going up extraordinarily rapidly in areas where presort discounts and other work-sharing devices have been used to stimulate volume.

Item 2 on the list, worker's compensation, was reduced by $327 million by changing the discount rate involved in worker's compensation funds. The Postal Service proposed a 7.5-percent return on that fund investment. We raised it to 10 percent which we believe is based on more recent financial market conditions. Ten percent interest is realistic these days. That results in a $327 million decline in the revenue requirement.

Contingency is the third item. We believe that the Postal Service overstated its contingency by improperly applying its revenue variance analysis for a period in which there was no uncertainty about the revenue levels.

We have recalculated productivity improvement based on real productivity rather than nominal productivity, which means just briefly this. Productivity is in two segments. One is increased productivity generated by postal employees. The second segment is productivity generated by the mailers themselves through work-sharing techniques like presort and other methods.

The Postal Rate Commission isolated Postal Service productivity from that portion of the work-sharing savings generated by the mailer. The reduction in revenue requirement here will allow us to reach rates which will now reflect the work-sharing savings to the mailer.

The civil service retirement fund liability was reduced by $123 million. This is really only a technical matter. The Postal Service included full payment in its revenue request, when in fact the Service will not begin paying until fiscal year 1982. Therefore, we made an adjustment there covering the period that falls within the test year.

We did not only reduce the revenue requirement. In some cases we added to it.

We restored what we felt to be an underestimated cost of living adjustment (COLA) fund. The Postal Service figure for COLA expenses was underestimated during the course of our proceedings. The PRC made the appropriate adjustment based on the Consumer Price Index. We added $144 million to the COLA item. We added $99 million in correcting what we found to be an error in the Service's estimate of third-class costs.

The total of the additions and subtractions is the $1 billion which is taken off the Postal Service's revenue requirement of $23 billion.

The Commission's reduction in the revenue requirement will be a prime cause of the lower rate, which in turn will elicit an estimated 2.1 billion additional pieces of mail. This will be mostly business mail. It will be a stimulant to business and I believe that it fits in extremely well with the kinds of activity which we heard about from the President last night.

This is a volume-sensitive decision. In the past, presort discounts have added dramatically to volume. In the past year, for example, there has been a 41-percent increase in 1 year of presorted first-class mail. There has been a similar, I think even more dramatic, increase in the third-class area. This decision will encourage that trend. I would expect volumes in those categories to shoot off the charts.

The rates which we recommended are different in a number of ways from those recommended by the Service, as you can see on the second chart. I can provide a camera copy of the chart for the record.

Senator STEVENS. Without objection, the copy of the chart will be included in the hearing record at this point.

[The chart referred to follows:]

SUMMARY OF USPS PROPOSED AND PRC RECOMMENDED RATE INCREASES

	USPS proposed	PRC recommended
1st class:		
Letters:		
Percent	33	20
New rate	$0.20	$0.18
Post cards:		
Percent	33	20
New rate	$0.13	$0.12
2d class (periodicals):		
Ordinary (percent)	2	[1] 1
Expedited (Red Tag) (percent)	2	[1] 27
3d class (advertising mail):		
Regular (percent)	29	24
Presorted (percent)	12	7
4th class:		
Books and records (percent)	1	5
Parcel post (percent)	11	13

[1] Includes 2.4 cents expedited service charge.

Mr. FRITSCHLER. In particular, we have recommended first-class letter rates of 18 cents for the first ounce and 17 cents for each additional ounce.

We recommended an intra-BMC discount of 14 cents per piece for parcels mailed and delivered within a single bulk mail center area.

We retained the distinction already accepted by the Postal Service Governors between expedited and regular second-class service and recommended a cost-based rate differential whereby expedited rates are 2.4 cents higher than they would be absent the distinction. Regular rates are 1 cent lower.

We recommended a presort discount for some categories of second-class mail that have not previously enjoyed them, and we generally modified the increases sought by the Postal Service.

The first-class letter increase proposed by the Postal Service was 33 percent. We have recommended 20 percent and 20 percent for postcards.

Ordinary second-class mail, periodicals, had a 2-percent increase in the Postal Service recommendation. Our recommendation is 1 percent.

Expedited or red tag we have moved up 27 percent. The reason for the large increase there is that the Board of Governors accepted the Postal Rate Commission's decision last spring on service-related costing and the surcharge for red tag periodicals. These are time-sensitive periodicals, any news magazine or newspaper published weekly or more frequently. However, in the spring they did not put rates into effect.

In this decision we are incorporating the new red tag surcharge and are putting in the surcharge differential along with the general rate increase. That makes it a high item this time, but it is a one-shot high item for this particular rate case.

In the third-class area, regular mail which is basically unsorted third-class advertising mail is 24 percent. Presorted is 7 percent. I would point out that the presorted mail is something approaching 50 percent of the third-class mail volume.

Fourth class, books and records, is a 5-percent increase. Parcel post is 13 percent as opposed to 11 percent.

There are numerous other important parts to our recommended decision. For example, we have established a new third-class bulk rate structure which eliminates cross-subsidization in that class, and we have established a surcharge of 50 cents to cover the extra costs of parcels because of heavy weight or unusual shape or content which cannot be handled by the Service's mechanized equipment.

The new discount for parcels sent and delivered within an area served by one bulk-mail center is not affected by that surcharge.

Most of the technical points will, I think, be better understood by reading the relevant portions of our decision or perhaps by specific questions.

If I were allowed to make only two points in summary about our decision, I would say that our recommended rates are anti-inflationary and are in full compliance with the break-even or pay-as-you-go provisions of the act.

They will generate the revenues necessary for postal operations for the test year and beyond.

There is one other matter of great significance, Mr. Chairman. That is the annual report of the Postmaster General which was issued 17 days ago. Of course, we could not and do not rely on it in our decision because it was issued after our record was closed. Our record was closed on January 6.

However, four of us noted in our concurring opinion that the report corroborates our projections and adjustments to the Postal Service's revenue requirements. Consequently, this is a very important document in relation to this decision.

If it is agreeable, I will ask my colleague, Commissioner DuPont, to summarize that concurring opinion at this time.

Senator STEVENS. First, I would like to recognize my colleague, Senator Pryor, for any comments he might have. At the outset of the hearing I failed to do that.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Mr. Chairman, I was late. I apologize. I do not think that any of us are used to these early dawn patrol hearings which you have started.

I thank you, Mr. Chairman. I think these hearings are most meaningful since we have just gotten jurisdiction over this matter.

I am in the process of learning, as are many of my colleagues, about our role in postal rates and the Postal Service.

I would like to paraphrase President Reagan and wonder whether, if we could ask the American people, they think that the Postal Service's delivery system and the mail service is as good today as it was 5 or 10 years ago. I do not know what that answer would be, but I think it might be somewhat negative. I am not sure that it would but I think that it probably would be.

I hope that whatever we do and whatever decision is finally made and accepted, everyone concerned will keep in mind the quality of service of the Postal Service. That must be at the very forefront and the very top priority.

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Mr. Chairman, I have some questions for a bit later but none right now. I will yield back to you

Senator STEVENS. If it is agreeable to you, we will hear from Mr. DuPont. I know that Mr. Duffy had a dissenting opinion and would like to hear from him and then from Mrs. Steiger and Mr. Bright if they have brief comments. We will get to our questions after that if that is agreeable to you.

Senator PRYOR. Yes, sir.

Senator STEVENS. Mr. DuPont?

Mr. DUPONT. Thank you, Mr. Chairman. My statement will be a brief description of our joint concurring opinion and I anticipate it will answer your question as to whether or not the Postal Service will have to come and file for another rate increase in the very near future as Postmaster General Bolger stated a week ago.

I was joined in the concurring opinion by three of my colleagues. The concurring opinion comments on some new and very revealing facts regarding the deficit, expense, volume, and revenue projections for fiscal year 1980 and the interim period in this case given to us by the Postal Service last April at the beginning of this rate case.

The new facts to which I refer are actual performance figures, rather than projections, for fiscal year 1980 and the interim period. The actual performance figures are contained in official reports of the U.S. Postal Service submitted to the Postal Rate Commission and to the public earlier this month on February 2 and February 6.

They are the Postmaster General's Annual Report for Fiscal Year 1980, the Annual Worker's Compensation Report for Fiscal Year 1980, and the three Accounting Period Reports for Accounting Periods 1, 2, and 3 for Fiscal Year 1981. Essentially, they are October, November, and December of 1980.

Unfortunately, the statutory time constraints on our rates case and the late date in our decisionmaking process when we received these reports precluded us from reopening the record for comments from the parties and, more importantly, from the Postal Service on some of these figures.

Therefore, we did not use them at all in our deliberations or in the decision we are issuing today. However, they are so important that we chose to comment on them in our concurring opinion and to mention them for comparison purposes only.

Before making the actual comparisons of deficit, volume, and worker's compensation projections with the actual performance figures, I would like to comment briefly on the importance of these projections.

In considering rate change requests, our rules require the establishment of a base year at current rates with all its actual revenue, expense, volume, and cost figures. Then, a future test year is isolated with the revenue, expense, cost, and volume figures projected at current rates.

The projected deficit is then computed between current rates in the base year and current rates in the future year. That is the amount that has to be covered through new increased rates in the test year.

Because the test year does not immediately follow the base year but rather is separated by some intervening period, in this case by

the 18 months comprised of fiscal year 1980 plus the 6 months between the end of fiscal year 1980 and the beginning of the test year, March 21, 1981, the Postal Service also had to project revenue, expense, and volume figures for that intervening period.

Those projections provide very important roll-through numbers from the fiscal year 1979 base year through to the test year. With these projections all of us in the case, the Commission and all of the parties who have to pay the bill, can follow the progress of expenses and revenue through the intervening period into the test year, the year in which the new rates are to take effect.

The projections are critical to the very foundation of the Service's rate request and their justification for the proposed higher rates.

Let me first address the deficit projection for fiscal year 1980. In April of last year the Service's witness, Cavallo, gave us a projected deficit figure for the Postal Service in fiscal year 1980 of $682 million.

Earlier this month in the Postmaster General's Annual Report for Fiscal Year 1980, the actual deficit was cited as $306 million, or $376 million less than that which was projected.

The 6-month interim period projections were $984 million as a deficit, but the deficit for the first 3 months of that same period was only $105 million. The Accounting Period Reports gave us that information.

The $105 million figure means that the Postal Service must lose an additional $879 million during January, February, and part of March 1981 for its $984 million projected deficit for the 6-month period to be realized. We think that such an occurrence is highly unlikely.

It is obvious from these comparisons that the Postal Service's projections for 1980 and the interim period were greatly overstated. Because they are critical computations for arriving at the test year deficit and the rates needed to make up that deficit, the overstatements for fiscal year 1980 and the interim period possibly mean that the Postal Service's test year projections are similarly overstated.

Let me now address the volume projections. In this case the Postal Service projected a mail volume in fiscal year 1980 of 104,527 million pieces. The actual number of pieces handled by the Service in fiscal year 1980 was 106,311 million pieces, a figure 2 percent higher than that projected.

The interim period projections at the present time are pretty good. The Postal Service projected a mail volume of 52,741 million pieces for the full 6-month period. At the halfway point the actual volume figure is 25,923 million pieces. This indicates that the Postal Service is holding its own volumewise in the interim period.

It is almost a truism in ratesetting that, when you increase rates, you reduce demand. Using its 20-cent first-class rate schedule the Postal Service estimated a test year volume of 104,627 million pieces. Under our 18-cent first-class rate schedule we project a test year volume after rates of 106,574 million pieces. The difference between our higher volume and that of the Postal Service is 1,947 million pieces, 45 percent of which are first-class pieces.

The results of these volume projection comparisons with the actual figures indicate that the overstatements in the projections are, again, in the Service's favor.

Let me turn to a more complicated and more vexing problem. This problem came to light when we reviewed the Annual Worker's Compensation Report for Fiscal Year 1980. The Postal Service computes its worker's compensation expense on an accrual basis, using a model created for it by the national accounting firm of Ernst & Whinney.

In contrast, other Federal agencies and quasi-Federal agencies use an actual payout to the Department of Labor, reporting their worker's compensation expense.

We have accepted in our case the Service's accrual method as a reasonable basis for computing its worker's compensation expense. This expense is a large part of the Service's revenue requirement and deficit.

In this case the Postal Service in April of last year advised us and the parties in the case that its worker's compensation expense in fiscal year 1980 would be $750 million. However, the data contained in the Annual Report on Worker's Compensation for Fiscal Year 1980 showed that expense as $498 million, or $252 million less than what has been used in the rate case.

To complicate matters further, note 6 of the Postmaster General's Fiscal Year 1980 Annual Report in commenting on the worker's compensation expense states that a change was made in the input to the worker's compensation model resulting in increasing the loss for fiscal 1980 by $268 million. If we interpret that note correctly, were it not for the addition of the $268 million as a loss figure, the accrued deficit of the Postal Service for fiscal year 1980 would have been only $38 million.

This is a discrepancy that really escapes us at the present time and I believe should be explained by the Service.

The $38 million comes from the fact that the Postmaster General's Annual Report reports a net loss of $306,392,000 in fiscal year 1980. You would subtract from that figure the $268 million that was added to the model and you would come up with the figure which I have given you.

Senator STEVENS. Are you comparing apples and oranges? In their model they are not dealing with the realities of that year's actual figures. How can you take the figures from the model and put them over into actual experience?

Mr. DUPONT. The model is what we base our projections on and what the parties base their projections on. The model figure should not change. We use the same model. The same figures should also be computed.

The Postmaster General says that we added to that model the increase.

Senator STEVENS. Did you ask the Postmaster General before you made that assumption in terms of this decision?

Mr. DUPONT. No, we did not because we received the report on February 6, 1981. As I stated earlier on in my comments, we did not have time to ask. We feel that that should be explained. If we are in error, we would like to know where our reading went awry.

The $750 million projected expense for worker's compensation in fiscal year 1980 used by the Service to project its test year expense used this expense to project its $830 million figure for the test year. For reasons other than the ones we note here and as noted by Chairman Fritschler, we reduced this expense item to $503 million.

Nevertheless, because the $830 million was a large part of the computed deficit of the Service in the test year and there are questions with regard to its reliability, the Service's projected deficit for the test year indeed becomes suspect.

We are pleased that the deficit projected by the Postal Service for these periods was higher than what actually occurred and that the volumes projected for these periods were lower than what actually occurred.

However, we are very disturbed by the apparently large overstatement of their worker's compensation expense which was given to us by the Postal Service in this case. We are of the opinion that the Postal Service must give an explanation of this discrepancy, if indeed there is one.

After reviewing the actual figures and making the comparisons I have cited here, we are even more convinced that our decision to reduce the Service's revenue requirement in the test year by approximately $1.1 billion is sound. It did allow us to reduce the first-class letter rate from the Service's proposed 20 cents to our 18 cents and the other rate changes contained in our decision.

The rates we recommend are fair and equitable for all mail users and will provide sufficient revenues for the efficient operation of the Postal Service in the test year and possibly even beyond. Our decision meets all of the criteria and policies governing our responsibilities for ratesetting in the Postal Reorganization Act, as amended, and will benefit not only the mail user and the Service but, just as important, the American public.

That completes my statement, Mr. Chairman. I appreciate the opportunity to present it to you.

Senator STEVENS. Thank you. I will have questions later. Right now I want to say that most of my questions will be aimed at the fourth-class rate. I wonder whether the Act needs to be amended to indicate the congressional policy that that should be a class which is intentionally maintained at the lowest possible rate. You seem to have had a major impact on that class.

Mr. FRITSCHLER. The chart does not include the nonprofit fourth-class materials which, as you know, are subsidized.

Senator STEVENS. We will go into that further later.

Mr. Duffy, I believe you had a dissenting opinion, did you not? Would you like to tell us about it?

Mr. DUFFY. Thank you very much, Mr. Chairman and Senator Pryor.

I would like to point out to the subcommittee that this volume II, containing all of the numbers, figures, and so forth which are so mindboggling, was not before the Commission when it voted on Friday the 13th.

Mr. Chairman, I am pleased to have this opportunity to appear before your subcommittee today to express my views on a matter which I consider to be of crucial importance to all Americans—the financial stability and well-being of its postal service.

I confess to misgivings about the propriety of testifying on the subject of the Commission's $22 billion recommended rate decision prior to the rendering of a decision by the Governors of the Postal Service, but I believe you should be presented with both sides of the coin. Therefore, I have joined my colleagues in order to apprise you of the reasons for my strong dissent to their actions.

Senator STEVENS. Let me interrupt you here. I think that is a legitimate criticism of my decision to try to have this hearing. My impression of the last time we had an increase was that very few people knew what your recommendation was before it got to the Board of Governors. I thought there ought to be some attention given to this process because there are many people who are telling me that we ought to start a bill through Congress which abolishes your function.

I think we ought to bring out into the light of day what your function is and how you arrive at your decisions and to let the general public know how the Board of Governors treats your recommendations before we deal with the question of whether there should be a Commission.

I feel that there will be a bill that deals with the question of whether there should be a Commission, whether the procedure established by the Postal Reform Act in terms of ratemaking is a viable procedure. That is the reason for this hearing.

I want to thank you for participating in it. It was my decision that there ought to be more publicity on what you have done and how you reach your decisions and more public attention focused on the fact that you have gone into this in detail. Then we will see what the Board of Governors does with it before we get to the question of whether or not this process is a viable one.

Nevertheless, I agree with your comments.

Mr. DUFFY. Thank you, Mr. Chairman.

My basic disagreement with the majority is that they have cut over $1 billion from postal revenues without identifying any actual reductions in costs. They have thereby deferred payment of over $1 billion in accrued costs to the future, while simultaneously endangering the financial stability of the Postal Service and jeopardizing planned Presidential budget reductions in public service appropriations.

With respect to prior year losses, the majority has eliminated $449 million from postal revenues necessary to restore prior year losses, but have they actually eliminated the expense? No. They have merely deferred it to the next rate proceeding.

The majority recognizes that the Postal Service has accumulated $4 billion in prior year losses, that the losses must be recovered, and that recovery is a proper expense of the Postal Service during the test year. By disallowing the revenues needed to recover this expense, the majority has not eliminated it. The costs are there and they must be paid. I believe, therefore, that it undercuts the Service financially to acknowledge the costs yet refuse to provide revenues to pay for them.

With respect to contingency, besides reducing postal revenues by $1 billion, the majority has cut the Service's contingency request, the item authorized by law for unforeseen events, from $655.7 million to $393 million. This amounts to 1.8 percent of total ac-

crued postal costs and is drastically down from the 4 percent which this Commission authorized in the last rate case.

That amount, by the way, the Postal Service was forced to use up almost completely to meet unforeseen expenses which occurred after our last decision.

The Postal Service is faced with far more imponderables today than after the prior rate case. Aside from the continuing high level of inflation, budget cuts of approximately $300 million are contemplated by the President in the Postal Service's public service appropriations. Prior to the majority's actions, the Service could have absorbed the cuts in its $655.7 million contingency provision. Now, with its contingency reduced to $393 million and revenues cut by $1 billion, it will be lucky if it does not need to request more assistance from the administration.

The majority has not eliminated the unforeseen expenses of the Postal Service; rather, it has chosen to ignore them. It has thereby jeopardized the Service's ability to meet additional expenses, such as the President's budget cuts, which are certain to materialize in the future.

With respect to the workmen's compensation discount rate, the majority has cut $327 million from revenues needed to pay for accrued worker's compensation expenses. It did so, not by eliminating any actual expense, but by arbitrarily increasing the worker's compensation discount factor from 7.5 percent to 10 percent, thereby reducing the expense on paper.

I say arbitrarily, because no party to our case proposed a discount factor higher than 8.5 percent.

With respect to productivity, a so-called reduction of $143 million in expenses was achieved by assuming that real postal productivity would increase more than postal management had predicted. This conclusion was achieved despite the majority's own calculations which showed a negative trend and a decrease of almost 3 percent in productivity for the most recently calculated period.

With respect to the cost of living allowance, or COLA, through an arbitrary adjustment of the proper accounting procedures utilized by the Service, the majority shifted $123 million out of the test year, thereby, again, achieving a paper reduction in costs.

Altogether, the majority has fictitiously eliminated $1.3 billion in accrued postal costs from the test year, thereby ostensibly justifying its predetermined reduction in revenues. I believe it will soon become painfully clear that actual accrued costs do not disappear as easily as the majority was able to erase them from its decision.

On that point I would merely note that the majority had not even read its own decision before voting to adopt it. Most of volume II, to which I referred before, the hundreds of pages which provide the numbers and calculations on the actual impact of the majority's decision, was put together by the staff this past weekend and was never seen by the Commission even in draft form until it was sent to the printer.

It will be weeks before the precise impact of this decision will become known. That is why I have recommended that, should the Governors conclude, after properly analyzing the decision, that its impact is even more drastic than it appears on its face, they

consider immediately resubmitting it to the Commission for reconsideration.

For a more detailed analysis of the costs ostensibly cut by the majority, I respectfully refer you to my dissenting opinion.

Thank you very much, Mr. Chairman.

Senator STEVENS. Mrs. Steiger, do you have any comments?

Mrs. STEIGER. I have no prepared statement. I would simply state again, with due deference to my esteemed colleague, Jim Duffy, that the majority of this Commission is satisfied that this is a fiscally responsible decision. It provides the Postal Service with adequate funds to provide service to the American people through the test year and, we think, well beyond.

This 21,000-page evidentiary record is replete with evidence that the Postal Service's submission was indeed overstated. As our concurring opinion mentions, subsequent events have indicated that there were major overstatements in the revenue requirement. I think time will prove that this is a responsible decision and we are willing to stand by it.

Senator STEVENS. Thank you very much.

Mr. Bright, do you have a comment?

Mr. BRIGHT. Yes, Senator, if you will.

As a former Post Office Department official and having served on the Postal Rate Commission for 3 years, I do find that our decision, after due deliberation and after listening to the testimony and reading literally by the hours, is an excellent decision, a fair decision, and a most judicious decision.

I would like to sustain what my colleague, Chairman Fritschler, said, namely, that I feel it will be 2 years before another postal rate increase will be needed.

Certainly, our decision can only be said to be in line with President Reagan's philosophies on Government services.

I must comment on the Postmaster General's Annual Report. Commissioner DuPont did such a fine job of explaining it, especially the costing of the volume sections which certainly do sustain our decision. The productivity, as reflected in the annual report, is certainly going the way we predicted it would. However, we did not in any way use it as a tool in our deliberations for this case.

I would like to make one further comment, if I may, Senator. I noted with a great deal of thought your comment on the viability of the Postal Rate Commission.

Senator STEVENS. I was talking about the process as a whole, Mr. Bright.

Mr. BRIGHT. Yes, the process. Perhaps it should be abolished. Perhaps it should not.

Perhaps, if hearings are held on such an item, I would be invited to attend. I think I am eminently qualified to comment because, during my 8 or 9 years as a Postal Service official in the 1960's, I had at least some measure of work in the setting of rates. I know the way they were set. With my experience on the Postal Rate Commission, I think I should make a comment for the record at this time. That is, that in the old days the way in which postal rates were set was not the most efficient. I do not mean to go into details.

In the 1970's the way that rates have been set with respect to the PRC—I would give you my considered opinion and from the standpoint of experience, that there has been a great deal of improvement. Is it perfect today? Of course not. Not many things are. However, it is certainly a step in the right direction.

Again, I cite—without intending to take issue with Commissioner Duffy, although I obviously think he is wrong—the rate case which is before you and which we just presented. It is a fair one and a judicious one.

Thank you, gentlemen.

Senator STEVENS. Thank you very much.

Senator Pryor, do you have some questions which you would like to ask?

Senator PRYOR. I would like to ask a couple of questions, Mr. Chairman. Thank you.

I would like to ask the chairman, Mr. Fritschler, a question—Mr. Bright may have alluded to this matter a few minutes ago. I may have arrived too late to hear any discussion about President Reagan's address last evening and how the earlier than proposed phaseout of a postal subsidy will affect this particular recommendation. It seems to me that it would have a significant effect. If I missed that discussion, I apologize.

Mr. FRITSCHLER. There was no discussion of it. Let me begin it and some of my colleagues may want to join me.

First, I have not seen the specifics of the proposal, so I do not know exactly what part of the appropriation will be cut or when. I believe it is important to understand that the subsidies or appropriations which Congress gives to the Postal Service are by and large for specific services.

In other words, if the appropriation for revenue foregone is cut, the law already provides that the nonprofit mailer simply pays the regular rate that is paid by other mailers. Therefore, there is no cost to the Postal Service in that case.

The other part of the appropriation, the public service appropriation, is made for specific services like rural free delivery or perhaps Saturday service. In other words, it is almost impossible to predict how the cuts would impact on the Postal Service because, on one hand, the cut would simply mean that nonprofit mailers would be paying the Postal Service more and, on the other hand, it would mean that the Postal Service would be cutting back services.

It is completely possible for the cut to take place without any effect whatsoever on this decision.

We base our decision on the data before us, which includes the appropriation. We set the third-class and special fourth-class rates at this level. Then, we reduce them by the amount of the appropriation for the nonprofit mailers.

Senator PRYOR. When you made this finding, with Mr. Duffy dissenting, at that time you did not know of the President's decision to cut $632 million from the subsidy.

Mr. FRITSCHLER. We did not. We only considered things which were on the record as of January 6.

Senator PRYOR. This recommendation which is now going to Congress would, I would think, have a significant effect on your

recommendation. Would it justify a new set of hearings, going back to square one?

Mr. FRITSCHLER. No. I would expect it to have no impact at all because it would result automatically in higher rates for the nonprofit mailers, which would mean that the Postal Service instead of getting part of their funds from the appropriation would get it through nonprofit rates.

The other question would be Saturday delivery and services which are supported by the congressional appropriation. If Saturday delivery, for example, were discontinued, I believe it has been estimated that that would save $500 million in the first year. That would be almost all of the amount.

The Postal Service would break even. Congress pays the Postal Service to perform certain functions on which it could not break even. I hope that is clear.

Senator PRYOR. Mr. Chairman, if I may, I would like to recognize Mr. DuPont.

Mr. DUPONT. There are two types of appropriation, as you are aware, that are received by the Postal Service out of the general Treasury. One is the revenue foregone appropriation which allows nonprofits and certain classes of mail to have their rates phased in rather than pay them. Whenever we set a rate, we set a full rate. From that full rate are deducted certain parts of the rate, like phasing, on a percentage basis. That is a revenue foregone appropriation which goes through the Postal Service.

We do not know for what the $630 or so million cut being recommended by President Reagan is. Still, with respect to the revenue foregone appropriations, if that cut goes by the board, then automatically under the provisions of section 3627 of the act the Postal Service is authorized to get from the mailers the full rate because Congress has failed to approve the rates or the Government will not give those moneys to the Postal Service.

Then there are public service appropriations under which, as cited in the act, there are such things as rural mail service or rural post offices. If the cut comes in the public service area, then possibly the Postal Service will have to cut or reduce that service.

Therefore, until we see the particulars of the President's recommendation, we do not know where the cuts will come. If they are in public service appropriations, then assumedly the Postal Service under the terms of the Postal Reorganization Act would have to submit a request for a change of service to the Postal Rate Commission. If not, it is automatic under section 3627.

Senator PRYOR. In layman's terms, we are taking out roughly $600 million from what was going to be considered as income. Ergo, it looks as though we would have to raise the rates further for certain types of mailers to make up the difference.

Mr. FRITSCHLER. Just for the nonprofits and preferred classes.

Senator PRYOR. Or, we would have to cut back services in some other way.

Mr. DUPONT. If we cut back services, section 3627 says that the Postal Service can either cut back services or file for a new rate—I am sorry. Section 3627 calls for either cutting back on services or cutting back of the public service appropriations. That allows the

Postal Service to either come in for higher rates to make up the deficit or to reduce services.

Senator PRYOR. Mr. Chairman, while I am asking questions, may I ask one or two more?

Senator STEVENS. Certainly, go ahead.

Senator PRYOR. I do not want to monopolize the time.

One concern I have is this. It does not go to the President's speech last night. I have heard that in the area of first-class mail, business sends out roughly 80 percent and that individuals send out 20 percent. I have heard that business has writeoffs because of certain tax preferences and that there are certain other ways in which they can decrease the impact of the now 15-cent stamp. I have heard that the private individual has no way whatsoever in which to mitigate the impact, so to speak.

If we go to 18 cents, is there any conceivable way that we can distinguish between business mail and personal mail, or is there any way that we can distinguish or perhaps allow senior citizens to buy a packet of stamps at a reduced rate, since this is an important way that they have of communicating? They do not have money to call long distance, so mail is their No. 1 source of communication.

Mr. FRITSCHLER. We share that concern, Senator. In the past, the Commission has had before it various proposals to set up a new subclass of first-class mail which would provide a lower rate.

In this decision we have recommended that we, the Commission, open a new docket and we intend to do so. This docket is something we will call two-tiered first-class mail. It would be two classes of service for first-class letters. It is a system which is used in England, France, and many other countries. In France it is called fast mail and slow mail, or something like that.

The point is that the 18-cent regular rate, first-class mail would meet the most rapid delivery standards of first class, whereas the second tier which would go for a lower rate would be sorted and delivered on a different schedule. Consequently, it would cost less and could be priced less. The service standard would be slightly but not significantly lower.

This would mean that the citizen would have an option. If he or she had a letter he wanted to get to a loved one in a hurry, it could be sent through the regular first-class mail stream with a maximum 3-day delivery standard. If it were a check for the local dentist which had no high priority in terms of timing and could arrive 2 or 3 days after the regular mail, it could go at a lower rate.

Senator STEVENS. The reverse of that is also true, is it not? That is, normally a business letter would be delivered on just 5 days of the week, whereas personal mail going to farms and homes throughout the country would be delivered 6 days a week.

Mr. FRITSCHLER. That is correct.

Senator STEVENS. Therefore, the cost of 6-day delivery, $500 million, is on the personal individual side, is it not?

Mr. FRITSCHLER. That is correct. That is true almost entirely, except for things like newspapers and other items which are delivered to homes.

Mrs. STEIGER. It should also be noted, Senator, that the business mailer of first-class mail does do substantial work-sharing with the Postal Service, for which we do provide a discount.

Senator STEVENS. There is already a discount there.

I think that two-tiered system would be a very interesting procedure to pursue to see if we might answer the question of 6-day delivery, or Saturday delivery, in terms of the postal rates.

Mr. DUPONT. Mr. Chairman, if I may also comment on the 80 percent-20 percent figure which you quoted. The 20-percent figure only applies to household-to-household mail. The 80-percent figure applies to business generated mail. When you or I send a check to a business for a payment, that is part of the 80-percent figure. The 20-percent figure is purely household-to-household mail. Household-to-business comes under the aegis of business generated mail.

As the chairman stated, we addressed this matter under the citizen rate in the previous rate cases. In that rate case the Postal Service said that there should be a 3-cent difference between business mail and household mail. The problem we ran into then—the Postal Service came to us and said: "When we have a delivery crunch, the reason for the lower, 3-cent difference between business mail and household mail was that it is deferrable mail." That means that when there is a crunch in the delivery section of the post office, they will go through the mail and extract the household mail and defer it. They will send on the business mail.

The problem with that was that, when the mail comes from sectional centers or the place where all of the mail is put together, all letter-type mail is commingled. They are all together in the same trays. When that mail comes through the delivery section, if mail from households were to be deferred, they would flip through all of the commingled mail and extract. The cost ramifications are significant. The point was to save money, but we would be adding costs.

Therefore, we rejected the citizen rate and settled on the 15-cent stamp for everybody.

Senator STEVENS. We will be interested in seeing what the results of your new docket will be. From my personal point of view, it would be interesting if we could determine the acceptance of a stamp which would indicate, even on individual personal mail, that it was not to be delivered on the sixth day, on Saturday. That is if it were definitely slow mail in the European sense.

Up my way, some of the mail planes only come once a week. They never come on Saturday. [Laughter.]

Mr. BRIGHT. Senator, may I make a comment on the citizen's rate?

Senator STEVENS. I would just as soon get into the subject before us now, Mr. Bright, if you will pardon me. This is a rabbit trail that my friend here opened up. It is certainly a viable one and a very interesting one, but it is not what we are here for today. Let us wait until that comes before us, if you do not mind.

I do want to comment that in 1978 the rate was 13 cents. We went up to 15 cents. Now, if your recommendation were followed, it would be 18 cents. In that period of time there has been a 32-percent increase in general Government costs. The result of your

recommendation would result—if I have it figured out right—in a 38-percent increase in postal services rates to the user.

Did you compare the decision to recommend the increased rate to the overall costs of other Government services?

Mr. FRITSCHLER. No, sir. We used an analysis with the CPI and the inflation factors which the Postal Service gave us.

Senator STEVENS. How does your recommendation compare to the rate of inflation since the last increase?

Mr. FRITSCHLER. If you mean since our last increase, it is 15 percent and the inflation rate is 36. Let me tell you how we got there. I have it written down because I thought you would ask.

Senator STEVENS. Did you say 15 percent?

Mr. FRITSCHLER. Overall. That is the total revenue requirement.

Senator STEVENS. You are taking inflation into account since the last rate.

Mr. FRITSCHLER. No. Inflation since the last rate case was 36 percent. Our overall increase in rate is 15 percent for the same period. I will show you why that can be done.

The CPI went up 36 percent, as I already indicated, but the accrued cost per piece of mail went up only 10 percent. That is equivalent to the increase in salaries and benefits per worker year of 24 percent, less the gains in productivity of 13 percent.

The inconsistency between the 36-percent increase in the CPI and the increases we are recommending in the cost of the per-piece charge of mail just demonstrates the inappropriateness of taking a straight-line formula with inflation. The CPI and other inflation factors measure things which do not impact on the Postal Service and do not take into account increased mail volume, worker productivity increases, and work-sharing productivity increases.

I might just add a footnote to that. This is one of the reasons why using the general CPI in calculating all sorts of things leads unnecessarily to even more inflation.

Senator STEVENS. You are going from the 1978 decision. I was looking at the rate increase from the time it was 13 cents.

Mr. FRITSCHLER. I am sorry. I was starting from the last rate decision.

Senator STEVENS. If you look at 1978 until now and counting that increase, it was 13 cents before, so we went up in 1978 to 15 cents. Now, if we follow your recommendation, it will go up to 18 cents. It seems to me out of line as far as all other costs are concerned.

Did you take into account at all the question of productivity as far as the Postal Service is concerned?

Mr. FRITSCHLER. Oh, yes.

Senator STEVENS. How does it relate to your recommendation? Has there been some increase in productivity?

Mr. FRITSCHLER. Absolutely.

Senator STEVENS. Has that been true in the last 3 years?

Mr. FRITSCHLER. Yes.

Senator STEVENS. What is the rate of increase in productivity for the Postal Service?

Mr. FRITSCHLER. In the last year—There are two types of productivity. There is the nominal simple productivity. Then there is the productivity based on mail mix.

Senator STEVENS. You are assuming that the productivity where the mailer does part of the work which the Postal Service used to do is an increase in productivity of the Postal Service. Is that correct?

Mr. FRITSCHLER. No, not if you use the proper formula, which is the one that was used in this decision. In that case, the productivity increased at a rate of about 1.5 percent, I believe, in the last year—significantly.

Senator STEVENS. As my colleague has stated, we are getting into a subject that has been dealt with in years past. It has not been my impression as an observer on the sidelines and in the full committee that there has been much increase in productivity in the Postal Service in the last few years.

Mr. FRITSCHLER. There has been some but coupled with the work sharing of the mailers, the productivity increase has been significant. This decision reflects that.

Senator STEVENS. Your point there was very valid, that there is a productivity increase due to the shifting of the workload onto the mailer in presort and other incentive-based activities.

Mr. Duffy, do you wish to comment on that?

Mr. DUFFY. Yes, Senator. Since the 15-cent stamp was adopted in 1978, there has been a 40-percent inflationary increase. The Commission in its majority opinion recommends only a 20-percent increase. It will not work.

Senator STEVENS. Thank you.

One of the things that you have done, Mr. Chairman—and Mr. Duffy pointed that out—is that you have assumed a disparity in the workmen's compensation discount rate. How did you get your figure? I believe you used 10 percent; did you not?

Mr. FRITSCHLER. Yes.

Senator STEVENS. How did you get your figure of 10 percent? Are they earning that amount?

Mr. FRITSCHLER. Yes. They are earning more than that now. It is 13 to 14 percent at the present time.

In their proposal they set their rate at 7.5 percent, which we simply considered to be too low, especially given the fact that in the current year they are making 13 to 14 percent on it. Therefore, we raised it to 10 percent.

Senator STEVENS. Those funds are invested. They are accruing interest according to the current market rate.

Mr. FRITSCHLER. Yes. They are invested in Treasury bills.

Senator STEVENS. Let me ask you some other questions. We will have a hearing next week on the nine-digit ZIP code proposal. I have my own ideas about that but we will go into that then.

Is that at all involved in your rate recommendation?

Mr. FRITSCHLER. No, not at all.

Senator STEVENS. Does it assume any determination as far as the nine-digit ZIP code is concerned?

Mr. FRITSCHLER. No, but we do assume that we will be getting a docket from the Postal Service on the nine-digit ZIP to consider it in its financial and rate aspects.

Since we will be getting it, it would be improper for us to make any statements about it at this time. It was not at all a part of this decision.

Senator STEVENS. I should tell you this. Last night I asked the Postal Service to consider using five digits and four letter symbols at the end. You would actually increase the utility of the new equipment by a greater factor if you used the alphabet rather than digits.

There appears to be no objection to five digits plus letter symbols to improve delivery.

Mr. FRITSCHLER. That is what the Canadians do.

Senator STEVENS. As a matter of fact, it was originated in Japan. They do it there, too.

Mr. FRITSCHLER. Can you imagine the machines that read those characters? [Laughter.]

Senator STEVENS. They do it. As a matter of fact, they use a symbol of a dash. They increase their usability of every slot by different symbols—a star, a dash. They add to the number of times they can use one slot on their machines. The permutations give them a much greater volume on the same machine load.

Have you assumed anything concerning the proposal to negotiate long-term rates with the Service as far as mass volume users are concerned?

Mr. FRITSCHLER. No, sir. That was not a part of this decision.

Senator STEVENS. Have you done anything with regard to determining the extent of the Postal Service's ability to ascertain the exact cost of handling various classes of mail?

Mr. FRITSCHLER. We have worked with the Postal Service and they have made remarkable strides forward on their own to do this. In this particular docket we incorporated several new studies and we considered them. Some of the materials we thought were excellent and we used them. Some of them were rejected.

We have reached an assignable level of 73.6 percent of postal costs in this proceeding. I think that is a very good figure and the Postal Service deserves a great deal of credit for allowing us, so to speak, to reach——

Senator STEVENS. That is higher than anything we have heard before.

Mr. FRITSCHLER. It is slightly lower. I think last time it was just over 74 percent but it is essentially the same.

Senator STEVENS. The role of attributable costs is over 70 percent now. Is that correct?

Mr. FRITSCHLER. 73.6.

Mr. DUPONT. That is attributable and assignable.

Mr. FRITSCHLER. That is correct.

Senator STEVENS. What about nonprofits? Will we actually get some data which we can use with regard to nonprofit mail?

Mr. FRITSCHLER. Yes.

Senator STEVENS. If we had a hearing on that, would you be prepared to substantiate some figures on what you would consider to be assignable costs on nonprofits?

Mr. FRITSCHLER. Yes, sir.

Senator STEVENS. Obviously, it will come up following upon the President's recommendation last night.

Mr. DUPONT. If I may comment on that, this is one of the places where we disagree very strongly with the Postal Service. They came up and said: "We can only trace 52 percent of our costs in

this case." We came up and said: "No. You have regressed. We will go back to the system of using service-related costs. Under the system which we used in the last case and which we feel is pertinent and particularly sound in this case, we go up to 73.5 percent."

Progress was made by the Postal Rate Commission. We felt that the Postal Service had retrogressed. We criticized that in our decision, Mr. Chairman.

Senator STEVENS. I have a few more questions. Let me see if my colleague has any more. I hope we will end the hearing today before 10 a.m. I do want you to have a fair balance of the time, my friend, so if you have any questions, go ahead.

Senator PRYOR. Mr. Chairman, I would like to ask the members here—Let me back up for just a moment. We are looking at a subsidy which evidently will be less than was anticipated. Second, we are looking at a postal rate which in most instances will be an increase in income.

However, have we really studied a third element? That is one proposed by Senator Goldwater and Congressman Goldwater, father and son, on the usage of stamps in the free enterprise system of advertising. What has been considered here? Is this a sacred area in which no one should trespass?

Mr. FRITSCHLER. This is an issue—which I can thank God—will probably not come before us. I think that is strictly within the province of the Postal Service to decide whether or not they want to use such a system.

The rate charged to have the 7-up 7-cent stamp would be up to us, I suppose, but adopting the system would not fall within our province.

Senator PRYOR. I do not think that you like the idea. Is that right?

Mr. FRITSCHLER. I do not want to close my mind to anything new or innovative, Senator.

Senator PRYOR. I wonder if the Japanese use that, Senator Stevens. [Laughter.]

If they have not, I bet they will before too long. They have a way of coming up with some pretty hard acts to follow.

Finally, I would like to say to the members that I think the American people have no idea—I hate to say this—who you are. They do not know that you exist. They think not only that the Congress still sets postal rates but also that if their letter is late or their package did not arrive, they do not blame it on any of you five distinguished ladies and gentlemen and they do not blame it on anyone in Washington except Senator Stevens, Senator Pryor, and Congressman Jones.

They still do not realize that there has been a drastic change over the past decade in the system that we provide for mail delivery services.

I hope that you will take that into consideration. We actually have no control over whatever you do and certainly over whatever the Postal Service does. Nonetheless, we are the ones who generally take the blame for it—and not a great deal of credit because of it.

Again, I would accentuate service and delivery to people as we proceed in these hearings. I will also stress that point with the Postmaster General.

Mr. FRITSCHLER. Thank you. We appreciate that, Senator Pryor. We are doing everything we can to try to retain the highest level of service in the Postal Service.

Senator STEVENS. I have a couple more questions. Have you assumed anything different from the Postal Service with regard to employee compensation in this case?

Mr. FRITSCHLER. No, sir.

Senator STEVENS. You accepted their provisions as to how much employee compensation costs would increase in this period of time.

Mr. FRITSCHLER. Yes, sir, except for the adjustment of the workmen's compensation.

Senator STEVENS. We intend to get into that too. I understand that there is a labor negotiation coming up before the middle of the year.

Do you have some comment on my question to the chairman?

Mrs. STEIGER. Only that we used the procedure of presuming contract settlement will follow the same pattern of the last contract settlement. This has always been done in rate cases as the least intrusive in the negotiation process. It is the figure which the Service gave us in their submission. We have not changed it.

Senator STEVENS. You do not second-guess them on what they would settle for.

Mrs. STEIGER. That is correct.

Senator STEVENS. We will go into that later. I understand that it is controversial.

Do you have any idea what the cost will be of these two documents to the public? I am referring to volumes I and II.

Mr. FRITSCHLER. Our annual budget is $3.5 million for the agency, which does not all go into the rate case because we are doing many other things too. In the year in which we have an omnibus rate case like this, I suppose 60 to 70 percent of our expenses are directly tied to the rate case.

I cannot project with any accuracy what it costs the Postal Service to appear. I imagine it is a substantial amount of money. On the other hand, what we are asking for is simply good sound management data, which they must prepare in any case.

Therefore, I do not think that the marginal costs of appearing before us are very great. They would be gathering the data to make their own rate increases to whomever they would make them.

The third major element is the cost of the parties who appear before us. That is also very substantial. I have no idea what the very able members of the bar who appear before us make by the hour, but I imagine that it adds up to a very substantial bunch of fees.

It is fairly expensive to provide this kind of due process. However, I think these things should be put into perspective. This is a $22 or $23 billion proceeding. It is about 1 percent of the GNP. It effects every citizen of this country, every business in this country, and it is, as Senator Pryor mentioned, one of the things which Members of Congress hear about most frequently.

I did a quick calculation last night and discovered that our $3.5 million annual budget amounts to exactly 1 hour and 20 minutes of postal operations in any given year. We are a very small blip on their screen.

Senator STEVENS. I do not think we are being critical of the costs, but we ought to know what the cost of the procedure is.

What about the OOC? Do you fund them?

Mr. FRITSCHLER. Yes. The OOC and his staff are funded out of our $3.5 million.

Senator STEVENS. I do not know about my colleague, but I have received more complaints about their role in this rate case than about anything else. Briefly, what was their proposal to you? I understand that they made a totally different proposal.

Mr. FRITSCHLER. They used a completely different set of costing theories, which we rejected in 1975. They came up with a rate structure which included an 18-cent stamp but put the entire burden for the reduction in first class onto other classes of mail, which we felt resulted in an absolutely unconscionable rate structure that generated many complaints not only in our hearing room but also in the general public.

I appreciate the opportunity to say once again, that we rejected both the theory and the ensuing rates that came out of the theory. I do not want to be overly harsh with the representative of the general public, that is, the OOC, but I think that it is fair to say that very little in their case was adopted by us this time.

Senator STEVENS. This may be subject to an answer later. I understand that one of their proposals was a 137-percent increase in third-class mail. Is that right?

Mr. FRITSCHLER. I think that is right for one of the classes of third-class mail.

Senator STEVENS. That presents a serious question as to whether or not we should be using taxpayers' money to pay for a presentation before your Commission which is directly contrary to the public policy involved in third-class mail. I think that we will go into the question of how the money is being used if it is made available to the Commission—in any event, with regard to whether or not there should be a reorganization.

I was further told that they argued that, if the rate they proposed forced the third-class mailer to stop using third-class mail, that was all right.

Mr. FRITSCHLER. We rejected all of it, Senator. I feel relieved that this morning I can at last talk about it. We sat and listened for 10 months without being able to say anything.

We rejected it. Over that 10-month period we had the same reaction which, I guess, you are having right now.

Mrs. STEIGER. It should be noted too that the Commission had no control over the case submitted by the Officer of the Commission. He functions as an individual intervenor, supposedly on behalf of the public. We had no idea what his case submission would be when it was submitted.

We operate under ex parte considerations with him, just as we did with any other party.

Senator STEVENS. I think, at the very least we ought to look at the act to determine what ought to be the confines of his presenta-

tion at the taxpayers' expense. If there is a legitimate argument that is not presented to the Commission on behalf of the public by members of the public, perhaps there should be a way to bring it in through an OOC-type of operation, but to have a whole case presented through the forum of the mail service——

I guess I am prejudiced because, you see, I come from a part of the country that still relies upon the mail service totally. I just cannot see anyone being subsidized by the taxpayers to present a case which would in effect cut off one of the basic services which keeps rural areas alive.

Mr. FRITSCHLER. Before this case began, Senator, the Commission was working on policy guidelines for intervenors including the OOC, which might have avoided some of these problems. Unfortunately, we were not able to adopt them before the rate case was filed.

I will pledge to you that we will go back into them now that we properly can. I think they would go a long way toward correcting this problem.

Senator STEVENS. Do you have any further questions, Senator?

Senator PRYOR. I have a philosophical question. I wonder, Mr. Chairman, if you think that the Congress as an institution has too little to do today with the Postal Service and with this service, as you say, that affects every American citizen.

Mr. FRITSCHLER. Let me say that one of the results of ending the public service appropriation would be to break fairly directly and completely the one remaining strong tie which the Congress has to the U.S. Postal Service. For that reason, I believe that the public service subsidy should be looked at not only as a subsidy but as an avenue for input for the Congress into the activities of the postal corporation.

When that tie is severed, if there were no appropriation, the only linkage between the Congress and the Postal Service would be the Postal Rate Commission.

Senator PRYOR. I believe Mr. Duffy had a response to that.

Senator STEVENS. Mr. Duffy?

Mr. DUFFY. Mr. Chairman, I was going to say that I think that the Congress certainly has the right to exercise its jurisdiction as the legislative body over the Postal Rate Commission, but I would hope that it would not want to assume that kind of personal responsibility for the setting of rates again. I think that is a very very difficult and complex problem.

I would also like to say that it does cost millions of dollars for the Postal Service and for the Postal Rate Commission and the intervenors to become involved in a major rate case. In this particular instance, when the monkey is put back on the back of the Postal Service and there is a prospect of another rate case coming immediately, it seems to me to be an extravagant waste of taxpayers' money.

Senator PRYOR. I think one of the reasons why the Congress in the early 1970's created the system that we have now was to take us off the hook from appointing the postmaster in Magnolia, Ark., or the rural mail carrier in Ogemaw——

Mr. DUFFY. They were worrying about votes.

Senator PRYOR. That is right. Usually, they made one happy. He went under civil service and could not do any politicking for you and you made about 30 others mad. It became a great liability.

Since then, I have always wondered whether that was a good vote that I cast in the House or whether it was a bad vote.

Mr. BRIGHT. May I comment, Senator? It was a good vote most assuredly, in my opinion. I refer you to my previous statement. I know how the rates used to be set. This is a great step in the right direction.

Senator PRYOR. Mr. Chairman, I am through.

Senator STEVENS. Thank you very much. I really do thank you. In the past we did have responsibility for rate increases but we do not have that responsibility now. I think we must share the responsibility for this problem we all face with respect to inflation and budget deficits.

I want to tell you that I commend you for the thoroughness of your review of this case in the relatively short time frame in which you had to make your recommendations. I think that the recommendations which you have made are fair under the circumstances of the inflationary pattern which we have undergone in the last 2 years particularly. We are basically dealing with the period from 1978 to 1980 in this matter.

I have some serious reservations about the fourth-class recommendation because of its impact on the areas that rely so exclusively on parcel post as opposed to other forms of parcel delivery. However, I am being provincial. That is my area in particular, as it is Mr. DuPont's area of Hawaii. They will really be impacted more heavily by the parcel post rate increase than will be any other area.

We will have to take a look at that. I hope that the final decision will reflect that problem.

It is my intention, as I have indicated, after this matter is finally determined by the Board of Governors, to look into the question of the organization of the Postal Service in its total apparatus to determine whether the Reorganization Act was correct in establishing this type of procedure for ratemaking. We have been asked to review it and we do intend to do so and to review the role of the OOC in the process to determine whether or not the total cost and time involved in reviewing the requests that are made through the OOC are time and money properly spent in the total process.

I thank you all again. I thank you, Senator.

Again, I will say that the meetings of the subcommittee, to the extent that we can do so, will be early so that we may go on to other matters which start at 10 a.m. I do thank you for your cooperation in this respect.

[Whereupon, at 9:30 a.m., the subcommittee was recessed to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

W. CANNON
NEVADA

COMMITTEES:
COMMERCE, SCIENCE, AND TRANSPORTATION
ARMED SERVICES
RULES AND ADMINISTRATION

United States Senate

WASHINGTON, D.C. 20510

March 2, 1981

Honorable Ted Stevens
Chairman, Subcommittee on Civil Service,
Postal Services and General Services
260 Russell Senate Office Building
Washington, D.C. 20510

Dear Ted:

The announcement of a series of new postal rate increases has created considerable resentment among users of the mail system and threatens to contribute to the continual round of inflationary pressures at work in our economy. The Committee's decision to hold this oversight hearing into present rate setting procedures is important in better understanding where the cost increases originate within the Service and whether more direct congressional involvement in the process is advisable.

The Postal Service is more than a business, although it should be run as efficiently as possible. It is a vital public service which should be available to the public on a reasonable basis. Because of the implications on inflation and personal as well as business commerce, the Congress must continue to exercise its oversight function and insure that rate increases are justified.

The recent phenomenal increase in the use of first class mail service indicates that, so long as first class rates are within the budget of Americans, they will use the mails. A round of new increases may, however, discourage use rather than provide necessary revenue. That would be self-defeating and should not be allowed.

Another concern of the Committee should be to review the various classes of mail to insure that rates for each are sufficient to pay its attributable costs. First class rates must not be allowed to subsidize other classes of mail, particularly 2nd and 3rd class rates. I support the Committee in its efforts and ask that this letter be made a part of the recent hearings record.

With best wishes, I am

Sincerely,

Howard

HOWARD W. CANNON

HWC:ka:ja

JOINT CONCURRING OPINION OF MR. FRITSCHLER, MR. BRIGHT, MR. DUPONT, AND MRS. STEIGER

Four of us wish to add to the opinion of the Commission, which we of course support, some observations on the financial situation of the Postal Service, as illuminated by certain recent public reports.

On February 2 and February 6, 1981, the Commission received official reports from the United States Postal Service citing actual experience figures for its Fiscal Year 1980 deficit, revenue, expenses and mail volumes and similar information for the Interim Period in this case, which covers the first three accounting periods of Fiscal Year 1981 (essentially, October, November and December 1980). These reports are: The Postmaster General's Annual Report for Fiscal Year 1980; the annual Workers' Compensation Report for Fiscal Year 1980; and, the Accounting Period Reports I, II and III for Fiscal Year 1981. We received these reports in the normal course of business and they were submitted to the Commission by the Postal Service pursuant to our rules and regulations.

Although these reports are official documents of the Postal Service and we could in all likelihood have taken official notice of them, we did not rely on them at all for our opinion and decision in this docket. One reason is that they were received too late for inclusion in our deliberations and second, this information was not available to the parties for comment on the record. If we were going to use it in our decision we would want to receive comments from the parties, but the statutory

ten-month deadline for issuing our decision--February 20, 1981--precluded us from reopening the record. Nevertheless, the information contained in those reports should be commented upon and we do so for comparison purposes, if only in this concurring opinion.

Background: Development of revenue requirement proposal

Before making specific comparisons of the Fiscal Year 1980, and Interim Period projections in this case submitted on April 20, 1980, with the actual deficit, revenue, expense and mail volume figures submitted on February 2 and 6, 1981, we must comment on the importance of the new data and the manner in which both sets are used in our analysis in this concurring opinion.

In considering Postal Service rate change requests, our rules require the establishment of a historical base year during which the current rates were in effect. A future Test Year is then isolated and current rates with their corollary revenue, expense, volume and other pertinent financial and operation data are "rolled forward" to that new twelve-month period. The resulting deficit, if any, is the basis for the new operating revenue requirement and changed rates proposed for the Test Year.

The Test Year does not begin immediately following the old base year. Rather, there is an "in between" period through which the "roll forward" figures are computed as estimates or projections. In this case, that "in between" period was Fiscal Year 1980 plus the six months between the end of Fiscal Year 1980 (September 30, 1980) and the beginning of the Test Year (March 20, 1981). This "rolling forward" is critical to provide continuity in costing and rate-setting calculations and to uncover any aberrations in the time periods under consideration. These figures along with those of the base year provide the critical foundation for the Test Year revenue requirement and rates.

In this concurring opinion we focus on the following: the differences between the Postal Service's deficit projections for Fiscal Year 1980 and the deficit that actually occurred; the volume projections for Fiscal Year 1980 and the actual volume; and, the contradiction (at the least) between the workers' compensation expense projection for Fiscal Year 1980 and the actual expense for that item in Fiscal Year 1980. This last matter is important because it constitutes a large part of the Postal Service's requested revenue requirement for the Test Year.

In addition, we make similar comparisons for the first three accounting periods in the Interim Period--the first three accounting periods for Fiscal Year 1981 (October, November and December, 1980).

Postal Service Deficit

To support its revenue requirement request for the Test year Postal Service witness Anthony J. Cavallo, Jr., submitted

as part of his testimony USPS Exhibit 3A which projected the Service's Fiscal Year 1980 deficit at $682 million. In contrast, the Postmaster General's Annual Report for Fiscal Year 1980 shows that the actual deficit was $306 million--$376 million below Cavallo's projection.1/

Further, witness Cavallo's Exhibit 3A showed an Interim Period projected deficit of $984 million for the entire six-month period between the end of Fiscal Year 1980 (September 30, 1980) and the beginning of the Test Year (March 20, 1981). By comparison, the accounting period, reports for the first three accounting periods of the Interim Period show an actual deficit of $105 million. This means that the Postal Service must have to lose an additional $879 million during January, February and part of March, 1981, for its $984 million projected deficit for the period to be realized. Such an occurrence, barring a drastic reversal in Postal Service fortunes, does not seem even remotely possible.

With regard to the Test Year before rates deficit, witness Cavallo used that same "roll forward" procedure to project a deficit for that year of $4,890 million, and an after rates deficit of $4 million. Our after rates figures show a surplus of approximately $9 million.

1/ At page 7, infra, we note that were it not for the $268 million adjustment to workers' compensation this loss would have been only $38 million or $644 million below Cavallo's projection.

The obvious conclusion from these facts and comparisons is that the Postal Service, in computing its Test Year revenue requirement, greatly overstated its FY 1980 deficit. We do not know the reason for such a large overstatement nor do we speculate what it might be.

Similarly, one can surmise that, although only three months of the six-month Interim Period have passed, the actual deficit for that period has been overstated even more by the Postal Service with the result that the projected Test Year deficit before rates, in all likelihood, is also overstated. As indicated in our Recommended Decision and Opinion we conclude that it has been.

Volume

Witness Cavallo's USPS Exhibit 3J gave us volume projections for Fiscal Year 1980 and the Interim Period. That exhibit projected the Fiscal Year 1980 total Postal Service mail volume to be 104,527 million pieces. In contrast, the Postmaster General's Annual Report stated that the actual FY 1980 mail volume was 106,311 million pieces or 2 percent higher.

Turning to the Interim Period, witness Cavallo projected a volume level for that six-month period of 52,741 million pieces. The three accounting period reports referred to earlier show that the Postal Service handled 25,923.6 million pieces, approximately half the amount projected for the entire period. Although not conclusive, it appears that the Postal Service is holding its own with mail volume during the Interim Period.

The Postal Service under its proposed rates projected a total after rates mail volume in the Test Year of 104,627 million pieces. Under the rates we propose, including the lower 18 cent first class letter rate, we project a total after rates mail volume of 106,574 million pieces in the Test Year. The difference between our volume projections using our rates and that of the Postal Service using its rates is 1,947 million pieces, 45 percent of which is first class letter mail.

We are pleased that the Postal Service's actually experienced mail volume for Fiscal Year 1980 was so much higher than that which was projected. It bodes well for the financial condition of the Service. We are confident that, under our rate structure, the Postal Service will indeed enjoy a favorable financial situation in the Test Year.

Workers' Compensation Expense

As we note in our Recommended Decision and Opinion the Postal Service computes its annual workers' compensation expense on an accrual basis rather than on the actual annual payout to the Department of Labor. This accrual basis uses a model created for the Service by the national accounting firm of Ernst and Whinney. Based on that model witness Cavallo, in his workpapers on page 237, estimated workers' compensation expense for Fiscal Year 1980 to be $750 million. However, from the aggregate cost data contained in the Workers' Compensation Report filed by the Service with the Commission on February 6, 1981 (a report that was due on December 15, 1980), we find that the expense for

workers' compensation in Fiscal Year 1980 has been recomputed to $498 million--$252 million less than that which was included in the Postal Service's list of expenses filed in this case.

We relied on the $750 million figure given to us by witness Cavallo and recognized that it was used to arrive at the Service's projected Test Year revenue requirement for workers' compensation of $830 million. We have attempted to discover from the reports submitted to us the reason for the $252 million difference between the figure of $750 million used by Cavallo and the $498 million figure contained in the Workers' Compensation Report, but have been unable to do so. If the same model and figures were used, as should have been, the results should be the same or an explanation submitted. We find no explanation given by the Postal Service.

Furthermore, Note 6 of the Postmaster General's Annual Report for Fiscal Year 1980, in referring to Workers' Compensation, states that a change was made in the input to the Workers' Compensation model. However, the change resulted in ". . . increasing the loss for fiscal 1980 by $268,000,000".[1/] If we interpret that note correctly, were it not for the addition of the $268 million, the accrued deficit for Fiscal Year 1980 would have been only $38 million.

If this is correct, we know that the $750 million figure projected for FY 1980 is grossly overstated and the $830 million projected figure for the Test Year may similarly be overstated.

1/ Annual Report of the Postmaster General, Fiscal 1980, p. 22.

Again, since this information came in so late, only two weeks before we issue this decision, and the parties had no opportunity to explore it on the record, we did not consider it in our decision.

For reasons other than what we have just cited above we, in our Recommended Decision and Opinion, adjusted the Postal Service's projected revenue requirement for workers' compensation to $530 million from the $830 million figure.

Conclusion

Our painstaking and intensive ten-month review and analysis of the Postal Service's filing and the evidence presented to us by the over 90 witnesses, convinced us that the revenue requirement proposed by the Postal Service in this case for the Test Year should be reduced. This we did even without the information we cite in this concurring opinion. That reduced revenue requirement of $1.1 billion resulted in our lowering the first class first-ounce rate from the requested 20 cents to 18 cents and many of the other rates as well.

After receiving the information on actual experience of the Postal Service which we mention above, we are even more convinced that our decision is correct. We are very pleased that the Service's financial condition for Fiscal Year 1980 and the first half of the Interim Period is substantially better than that which it forecasted when it underestimated volume and overestimated expenses.

It is almost a truism in rate-setting that whenever you increase rates you reduce demand. In this case, the rates we

recommend are lower for most mail users than those proposed by the Postal Service. With the reduction in the Test Year revenue requirement and the resulting lower rates for most mail users, we should see higher mail volumes in the Test Year than those projected by the Postal Service.

Based on our detailed analysis of all the evidence presented to us in this docket and encouraged by the reports we have cited above, we are confident that the decision we are recommending to the Governors of the United States Postal Service is sound and will provide sufficient revenues for the efficient operation of the Postal Service in the Test Year and beyond. It meets all of the criteria and policies governing our responsibilities in the Postal Reorganization Act, as amended, and will benefit not only the mail user and the Service, but just as important, the American public.

Simeon M. Bright
by David F. Harris
By direction of Vice Chairman Bright
SIMEON M. BRIGHT
Vice-Chairman

Clyde S. DuPont
CLYDE S. DUPONT
Commissioner

A. Lee Fritschler
A. LEE FRITSCHLER
Chairman

Janet D. Steiger
JANET D. STEIGER
Commissioner

Postal Rate and Fee Changes, 1980) Docket No. R80-1

DISSENTING OPINION

OF

COMMISSIONER DUFFY

James H. Duffy
Commissioner

Arpad de Kovacsy
Special Assistant

TABLE OF CONTENTS

I INTRODUCTION

II BACKGROUND

III REVENUE REQUIREMENT

A. Governmental Appropriations

B. Contingency

C. Prior Year Losses

D. Workers' Compensation Discount Factor

E. COLA Roll-In

F. Productivity

IV ASSIGNMENT AND ATTRIBUTION

A. Service Related Costing

B. Cost Segment Attribution Levels

V CONCLUSION

VI RECOMMENDATION

INTRODUCTION

I strongly disagree with the majority's conclusions and recommendations in this case and find that the revenue level established is clearly contrary to law, specifically the "break-even" requirement of Section 3621 of Title 39 which mandates that:

> "The postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service."

The decision by the majority to cut over $1 billion from the revenue request of the Postal Service without identifying commensurate cost reductions supported by the record, clearly violates the Postal Reorganization Act, engages in spurious cost-cutting, and improperly defers payment of present-day costs to the next rate proceeding.

I further believe that the arbitrary shift of costs and revenues from the first weight increment of regular first-class mail, the impact of which is temporarily obscured by the majority's decision to postpone payment of the Service's established costs, is unsupported by the record and will greatly disrupt mailing patterns in all classes once its full impact is realized in an imminent rate proceeding.

Although the majority's exercise in fictitious cost-cutting temporarily achieves a publicity-oriented 18¢ stamp, it unnecessarily risks financial disruption of the Nation's postal system and knowingly impairs the Postal Service's ability to absorb the public service appropriation cuts contemplated in the President's budget.

I would emphasize that I would be the first to cut unnecessary or wasteful expenses from any governmental budget. My recorded votes and actions on the Postal Rate Commission budget are ample proof of that.

But the majority has not reduced the predominantly fixed expenses of the Postal Service by temporarily refusing to pay for them. Rather, by limiting the revenues derived directly from the mailers, the majority is unlawfully postponing payment of accrued test year costs, endangering the financial stability of the Postal Service, and intentionally forcing increased public subsidization of postal costs upon the Nation's taxpayers.

It is my strong belief that the majority has done a great disservice to the Nation by mortgaging our future for the publicity it seeks today.

I am truly appalled that it would knowingly shift over $1 billion in accrued postal costs to a future rate proceeding, with the grave financial risk such a move entails, merely to project a false and fleeting impression of cost-cutting.

Its actions are clearly an extension of "the failed policies of the past" at a time when this Nation must face the realities of the present.

I am compelled, therefore, to voice my strong dissent in the hope that a future Commission will not bear false blame when it is faced with rectifying the harmful precedents established today.

II. BACKGROUND

On April 21, 1980, the Postal Service submitted its request for a rate increase estimated to provide total revenues of $22,959.3 million for the test year beginning March 21, 1981. This is an increase of 30% over the $17,616.9 million in revenues approved by this Commission during the last general rate case for the test year beginning March 25, 1978.[1/]

The Service's requested increase of 30% compares favorably with the Consumer Price Index (CPI) which will have risen by approximately 40% in the 3-year period between the advent of the two test years.

In its request, the Postal Service proposed a 20¢ rate for the first ounce of regular first-class mail. This 33% increase was also well below the increase experienced in the CPI since the 15¢ stamp was introduced in May of 1978.

In spite of the inflationary spiral which has buffeted the Postal Service as well as the general economy, the majority has slashed over $1 billion from the established revenue requirement of the Postal Service[2/] and arbitrarily reduced the increase in the first-class stamp to 18¢ -- a 20% increase over the previous rate.

1/ The actual rates were not placed into effect until May 1978.

2/ This reduces the revenue increase to 25% over the revenues approved three years ago for the March 25, 1978 test year.

For the majority to hold that a 20% increase in the first ounce increment of first-class mail (which has traditionally provided near half of all postage-derived revenues)[1/] will adequately meet its proportionate share of the increased costs of the Postal Service during a period of 40% inflation should, by itself, invite a certain degree of skepticism.

Any doubt concerning the soundness of this decision should be dispelled when the Postal Service shortly finds itself forced to file for another round of postage increases in order to meet the excess of $1 billion in accrued costs established on this record, for which the majority has deferred payment.

The primary aim of the majority has been to achieve a significant reduction in the recommended rate for the highly visible first-class letter rate without presently burdening the other classes of mail with the immense shift in costs this action necessarily entails.

This goal was achieved by temporarily postponing payment of over $1 billion in accrued postal costs to the next rate proceeding.

1/ Under the Service's filing, the first ounce of regular first-class postage provided approximately 40% of total revenues derived from postage and fees.

The over-$1 billion shift to the future was accomplished by:

(1) acknowledging the existence of $4 billion in prior year losses as a statutory cost of the Postal Service, but refusing to authorize the $449 million in test year revenues necessary to recover them;

(2) arbitrarily reducing the contingency request of the Postal Service by $263 million despite the preponderance of record evidence that even the Service's request would not be enough to meet the increased "unforeseen costs" which are now reasonably anticipated;

(3) an arbitrary increase in the workmen's compensation discount rate and a purely speculative increase in productivity which spuriously "eliminated" costs totalling $470 million;

(4) overturning accepted accounting principles to arbitrarily shift COLA expenses incurred by the Service in order to erase (on paper) $123 million in COLA costs from the test year.

These "reductions" amount to over $1.3 billion of existing costs, which have arbitrarily been eliminated, on paper, from the revenue requirement in order to create an illusion of cost-cutting. Since the Service's test year costs have actually increased by approximately $244 million since the filing of its revenue requirement, due to understated projections and incorrect calculations therein which the majority has acknowledged, the majority's net cuts in revenues approximate $1 billion, but the accrued costs which it ignores and passes to the impending rate proceeding exceed $1.3 billion.

III. REVENUE REQUIREMENT

A. Governmental Appropriations

The majority, by slashing over $1 billion from the revenues required by the Postal Service to meet its accrued costs for the test year, has endangered the financial stability of the Nation's postal system and deliberately undercut the Administration's efforts to reduce governmental subsidies to the Postal Service.

The majority decision intentionally cuts mailer-derived revenues by $1 billion below the costs of the Postal Service, while forcing an immediate $30 million increase in governmental subsidies.

The Presidential budget released on January 15, 1981, contained a rescission of $250 million in the Postal Service's public service appropriation for FY 1981 and a cut of $394 million for FY 1982. These cuts amount to approximately $322 million for the test year for which this Commission must approve adequate revenues.

Although the majority was well aware that similar cuts were certain to be made by the present Administration, which is firmly on record for slashing the previous Presidential budget request in most non-defense areas, it acted to undermine reductions in governmental appropriations by slashing the Service's required revenues more than $1 billion below actual test year costs.

Moreover, the majority acted to actually increase the Federal subsidy to certain mailers through revenue foregone appropriations by approximately $30 million in this test year alone.[1/]

This increase ensues as a result of the majority's conscious attempts to shift postal costs from the mailers onto the taxpayers.

The majority's actions not only endanger the financial stability of the Postal Service, but also contravene the intent of the Postal Reorganization Act that the Postal Service reach general self-sufficiency by 1984.

This Commission has long recognized the judgment and desire of Congress, reflected in the Postal Reorganization Act, that the Postal Service achieve general self-sufficiency by 1984. PRC Opinion, Docket No. R74-1, 1-43.

The Act provides for a yearly public service subsidy to the Postal Service of $920 million for fiscal years 1972 through 1979. The Act also provides that the subsidy be reduced by $92 million (10 percent) a year, beginning in FY 1980, until it reaches a level of $460 million in FY 1984. After FY 1984, the Act allows the Postal Service to eliminate the public subsidy if it is no longer necessary for providing the postal services mandated by the Act. See 39 U.S.C. §2401(b).

1/ Despite the fact that present indications are that the Administration intends to reduce Revenue Foregone Appropriations.

The wisdom of Congress and the success of the Postal Reorganization Act was borne out by the fact that the first reduction of $92 million in the public service subsidy came in FY 80, the year after the Postal Service had posted its first operating surplus in history. The Postal Service finished FY 1979 with a net income of $470 million, continuing a favorable financial trend which reduced its yearly deficits from $1.2 billion in FY 1976 to $688 million in FY 1977 and $479 million in FY 1978.

While the Postal Service ended FY 1980 with a net loss of $306 million, the filing of the present rate case was intended to make this deficit position temporary. If revenues equaling costs had been approved by the majority, the Postal Service would be well on its way to achieving the self-sufficiency contemplated by Congress and could even have absorbed expedited cuts in its public service appropriations through its $655.7 million (3%) contingency request.

By rescinding $1 billion in mailer-derived revenues, while simultaneously increasing governmental subsidies by $30 million, the majority has placed both the Postal Service and the President's proposed budget cuts in jeopardy. The majority has acted to force the taxpayers to pay for a greater share of postal costs while undermining the Service's ability to absorb contemplated budget cuts in public service appropriations.

The majority decision is contrary to the self-sufficiency mandate of the Postal Reorganization Act, works against the principle that postal costs should be borne by those who cause them, undercuts the budgetary policies of the Administration and unnecessarily places the Postal Service in a highly vulnerable and dangerous financial position.

B. Contingency

Section 3621 specifically includes "a reasonable provision for contingencies" as part of the Postal Service's revenue requirement.1/

The Commission has interpreted the Act to mean that the contingency provision provides a reserve in the revenue requirement for expenses which can neither be foreseen nor prevented through the exercise of honest, efficient and economical management. PRC Opinion, Docket No. R76-1, 1-52.

The role of the contingency was defined in Docket No. R76-1 to provide an allowance in the revenue requirement to "insure against unforeseen imbalances between costs and revenues" in the test year, the Commission noting in the last general rate proceeding that "an inadequate contingency provision can also lead to immediate harm, such as deterioration of service or plant." PRC Opinion, Docket No. R77-1, 1-23.

1/ "Both the contingency allowance and the provision for recovery of past losses are a mechanism for achieving a break-even position between costs and revenues (including appropriations), as required by §3621 of the Act." PRC Opinion, Docket No. R77-1, 1-23.

A reasonable contingency is required to meet test year imbalances between costs and revenues because, as the Commission has noted, imbalances are prospectively unidentifiable and not traceable to cost segments, and will occur as a result of errors in assumptions underlying projections contained in rate filing estimates arising from unforeseen events and/or errors employed by the Postal Service in its rate filings.

One such unforeseen event, still incalculable, which has occurred in this rate case, for instance, is the continued excessive level of inflation since the Postal Service prepared and filed its rate request on April 21, 1980.

In the prior rate case the Commission approved a contingency allowance comprising 4% of total accrued postal costs. In this proceeding, the Postal Service had reduced its request to 3% of the total accrued costs, or $655.7 million.

The majority has further reduced the Service's contingency request to 1.8%[1/], or $393 million. This amount would scarcely have been enough to meet unforeseen occurrences even if the majority had not slashed the Service's revenue requirement to a level $1 billion below its established test year expenses.

1/ The $144.1 million increased COLA adjustment for the test year, which the majority claims to have generously included as part of a 2.5% contingency, is no longer an unforeseen expense. It is an actual figure. The further COLA adjustment which will yet become a part of test year increases is still unforeseen and could very well use up a significant portion of the remaining contingency allowance.

The majority itself has cited factors relating "(1) to the economy, (2) the future labor negotiations, (3) reduced mail volume and (4) pending litigations," which this 1.8% contingency must cover.

Even without the over-$1 billion disallowance, this contingency could not reasonably be expected to cover much more than this. Add to it the other factors which we can reasonably expect to occur in the test year, such as (1) a remaining COLA under-estimate conceivably approaching the $144.1 million already computed, and (2) cuts in public service appropriations (slated to be $322 million under the former President's budget and certainly not much less under President Reagan's budget), and the majority has created a situation where the Postal Service could very possibly be in a cash-flow deficit position before it can implement new rates.

The majority has given the following argument for not being concerned with the impact its reductions in the contingency allowance and substantial revenue cuts could have on the Postal Service's ability to withstand these cuts in the short-term (i.e., until new rates can take effect):

"As indicated above, it is also important to consider, in the context of the contingency, the vulnerability of the Postal Service to revenue shortfalls or cost increases. In this connection, we note that the Postal Service's financial condition has deteriorated substantially as a consequence of the net loss of $_____ incurred since the end of the Docket No. R77-1 test year ... On the other hand in contrast to the declining equity position, there has been an improvement of the Postal Service's short-term ability to withstand financial adversity because of an improved working capital position.1/ The following table, which presents the year-end working capital position of the Postal Service for the years FY 1976 to FY 1980, demonstrates this point.2/

TABLE ___

FY Ending	Working Capital
June 30, 1975	$(520,584)
June 30, 1976	(753,026)
September 30, 1977	(368,038)
September 30, 1978	(452,727)
September 30, 1979	68,350
September 30, 1980	To be Supplied

1/ This improvement in the working capital position is no doubt, occasioned in large part, by the fact that the accrual of workers' compensation expenses results in the accumulation of working capital (through revenues to meet the expenses) which does not have to be applied to satisfy current term liability.

2/ See Annual Report of the Postmaster General Fiscal Year 1980, p. ___."

The foregoing statement, adopted as part of the Commission's recommended decision by final vote on February 13, 1981, clearly establishes the fallacy of

the majority's concern for the Service's financial position and its impact on it.[1/]

The Postmaster General's FY 1980 Report, which was released prior to February 13, shows that the Working Capital in the majority's September 30, 1980 "To be Supplied" item is, in fact, a negative $495.8 million.

The majority has, therefore, refuted its own argument for cutting the Service's revenue requirement below cost and for reducing the contingency provision.

I believe that the Postal Service has, as has been its practice in the past, again understated rather than overstated its revenue requirement. Unlike private companies, which are legitimately charged with making a profit, the Postal Service is charged with breaking even -- it is nonprofit.

The Governors of the Service, as well as its management, are directed by statute to serve the public and have no legitimate purpose or authority to overstate the Service's revenue requirement. Rather, as servants of the public, they are required to present their most accurate forecast as to revenues necessary to break even.

1/ A great many numbers and pages (including almost all of Volume II of the Decision) had not been completed and were missing from the unpaginated majority opinion adopted by final vote February 13, 1981. While I had access to some numbers and text changes being developed over the weekend the Commission was never presented with a final copy of the decision prior to the printing deadline on Tuesday morning, February 17, 1981. I have, therefore, been unable to provide page citations. The above statement appeared at pages 19-20 of Section II.V. "The Two and One-Half Percent Provision for Contingencies."

They have consistently given accurate, albeit conservative, estimates of their test year expenses to this Commission during prior rate proceedings and the record gives no basis to presume that they have done otherwise here.

For the test year in the last rate case (Docket No. R77-1), the Postal Service came within $38 million of using up its entire 4% contingency allowance to pay for unforeseen expenses occurring after the Commission's decision.

In Docket No. R76-1, the Postal Service's incurred expenses exceeded its 4% contingency request by $1.176 billion. While this was substantially due to recommended rates not being in effect for part of the test year, it nonetheless underscores both the Postal Service's tendency to file very conservative revenue requests, and the necessity for this Commission to act responsibly in making any significant revenue cuts.

It is an act of fiscal irresponsibility to cut $1 billion from the Service's revenue requirement and simultaneously reduce the contingency by $263 million. I firmly believe that the majority has acted in violation of the statutory mandate which requires "a reasonable provision for contingencies"," in reducing the contingency provision by $263 million to such a dangerously inadequate level.

C. Prior Year Losses

Although it strikes the entire prior year loss recovery from its decision, the majority acknowledges the existence of $4 billion in Postal Service prior year losses and the statutory requirement that recovery of these expenses is part of the lawful revenue requirement. It deliberately disallows their payment, however, thereby intentionally breaking the very law which it accuses the Governors and postal management of failing to follow.

In circumvention of the "break-even" requirement of 39 U.S.C. §3621, and contrary to past Commission decisions and the holding of the Court of Appeals for the District of Columbia Circuit, the majority has, with apparent disregard for the financial stability of the Postal Service, eliminated the entire $449 million prior year loss request from the revenue requirement.

This Commission determined conclusively in its Docket No. R76-1 Decision (issued June 30, 1976), that prior year losses, not necessarily included in operating borrowings, were part of the Service's "break-even" revenue requirement as mandated by §3621.

The inclusion of prior year losses as part of the Service's necessary "break-even" revenue requirement was unanimously reaffirmed by the Commission in Docket No. R77-1:

> "In order to ensure financial stability [the Commission found in Docket No. R76-1 that] §3621 mandated a provision for the recovery of prior year losses presented by operating debt. Once this Commission concluded that §3621 mandated a provision for the recovery of prior year losses represented by operating debt, we were confronted with the question whether prior year losses not represented by debt obligations should likewise be recovered .... We concluded 'the general principles of postal self-sufficiency which underlie the Postal Reorganization Act contemplate the recovery of prior year losses through rates and fees' to an extent not limited to those losses represented by debt."

The Commission next concluded that the Postal Service's equity position had continued to erode despite the prior year losses included in the revenue requirement and the infusion by Congress of a $1 billion subsidy:

> "As of September 30, 1977, the Postal Service had a deficit in equity of $588 million, compared to a surplus as of July 1, 1971, of $1,686 million. In 1976, the Postal Service's financial position was sufficiently precarious that it had to seek additional appropriations from Congress which resulted in its obtaining a $1 billion subsidy. Yet the erosion of the Postal Service's financial condition has continued unabated; losses of nearly $688 million in Fy 77 ... in addition losses are projected for the period October 1, 1977, to March 24, 1978, of $357 million. It is against this background that we examine the Postal Service's request to recover $334 million of prior year losses." (Docket No. R77-1, 1-48).

The Commission then held that "such a deficit in equity cannot safely be allowed to persist" (Docket No. R77-1, 1-48), and unanimously reaffirmed its Docket No. R76-1 decision to fully include prior year losses in the "break-even" revenue requirement mandated by §3621.[1/]

1/ The present majority apparently believes a deficit in equity of $718 million (as of September 30, 1980) can safely be allowed to exist alongside a $1 billion recommended revenue shortfall.

The United States Court of Appeals for the District of Columbia reviewed this Commission's determination that prior year losses were part of the §3621 revenue requirement in its recent NAGCP III decision. In its decision the Court examined the inclusion in the revenue requirement of prior year losses represented by debt and not represented by debt obligation, and concluded that:

> "... after examination of the legislative history of the [Postal Reorganization] Act, we hold that the Postal Service's election in these proceedings to recover prior years' losses not represented by debt through inclusion in the revenue requirement under Section 3621 comports with the legislative intent of the Act and is statutorily permissible."

The Court went on to say that "[T] he question whether a particular cost is includible 'is one of specific application of a broad statutory term in a proceeding in which the agency administering the statute must determine it initially.'" (Emphasis supplied).

Legal precedent, established in two prior Commission proceedings and affirmed in this most recent Court decision, have firmly established that prior year losses (both represented and not represented by debt obligations) are an indispensible part of the break-even revenue requirement mandated by §3621 of the Act in establishing postal rates and fees.

I most wholeheartedly agree with this Commission's legal staff, who unanimously concluded that the majority's actions in eliminating prior year losses from the revenue

requirement in this case is unlawful and would be indefensible in a court of law. But more importantly, I emphatically reject this shortsighted action because of the long-term harm it will effect upon the financial stability of the Nation's postal system.

That the majority persisted in striking these revenues from its decision compels the conclusion that it was guided not by costing principles, legal precedent, fiscal responsibility, or record evidence. Rather, its decision appears to have been driven by an overriding need to make spurious cuts in costs, in order to achieve its temporary reductions in rates.

The majority asserts that postal management and the Governors have followed policies inimical to the Act by failing to file rate cases when it becomes apparent that the Postal Service would not be able to annually retire the prior year losses contemplated by the Commission for the test year in the previous rate case:

> "Because this action contravenes the §3621 break-even requirement, it is not in accord with the 'honest, efficient and economical standard of management prescribed for the Postal Service.' Thus, for this proceeding, we are disallowing prior year losses from the Postal Service's revenue requirement." Majority Opinion at ____.

Aside from the absurdity of requiring the Postal Service to automatically file general rate cases when its revenues do not comport with the yearly prior year loss calculated by the Commission for a specific test year (a concept which would require yearly rate cases unless the world stood still), the majority has willfully violated the precise statutory provision which it accuses postal management and the Governors of failing to follow.[1/]

The majority's solution to recovering prior year losses on time in order to avoid financial insolvency is to disallow $449 million in prior year loss recovery entirely from the rate case.

It thereby unjustifiably violates the statute and causes the very financial disruption which the majority claims it is intended to prevent.

The majority's action in regard to disallowance of prior year losses is illegal, illogical, and unfortunately, intentional.

1/ Coincidentally, the majority's action follows the first full retirement of recommended prior year losses by the Postal Service. This occurred during the R77-1 test year ending March 24, 1979, when the Service achieved a surplus of $372 million.

D. Workers' Compensation Discount Factor

The Postal Service has calculated a workers' compensation expense of $830 million as part of its overall revenue requirement. To arrive at this amount the Postal Service has applied a 7.5 percent discount factor to its workers' compensation long-term liability to reduce it to its present value for the test year. The discount factor was justifiably based on 90-day Treasury bills since the Postal Service typically invests in 90-day U.S. Treasury bills.

The highest discount factor supported by any party to this proceeding was 8.5 percent, recommended by witness Arthur Eden on behalf of Reader's Digest Association. Witness Eden arrived at his recommended 8.5 percent discount factor by having the annual returns on 90-day Treasury bills weighted by the FY 1976-1980 annual average workers' compensation liability.

The majority arrived at its 10 percent discount factor by calculating the dollars it would need in order to achieve its revenue reduction goals. This method is commonly known as the don't-confuse-me-with-the-facts approach.

Of course, the staff has since diligently developed the rationale to support the majority's intuitive conclusion. I still cannot agree to it.

I find witness Eden's methodology to be rational and well-developed, comprising a basis which this Commission could, on careful examination, have utilized as an alternative to the Service's projections. The majority's calculations, however, were focused on the $327 million reduction in the revenue figure and no amount of after-the-fact graphs and rate-of-return yield histories can prospectively justify its predetermined 10 percent discount factor.

An added concern which strongly weighs against the majority's decision is that while a rationally arrived at increase in the discount factor will reduce test year expenses (if they actually occur), such a reduction in expenses is one-time only and no similar decrease would occur in subsequent years. This requires a conservative and cautious application of any projected increase in the discount factor.

I find that the $327 million reduction in revenues, which the majority has obtained by arbitrarily raising the discount rate, is unfounded in fact, arrived at through pure conjecture, not recommended or justified on the record, and in violation of the statutory break-even provision by unlawfully reducing postal revenues $327 million below accrued test year costs.

E. Cola Roll-In

In this proceeding the Postal Service has included $219.8 million in expenses caused by the roll-in of cost of living increases implemented during the period July 21, 1978 to July 20, 1981.

The Postal Service, following generally accepted accounting principles, recognized these costs at the time they were incurred, which is the time the liability arose. Hence they properly recognized the full COLA roll-in effective October 31, 1981 and correctly included the full $219.8 cost in the hybrid test year in this case.

The majority, on the other hand, improperly modified the Postal Service's accounting methodology and, through an inconsistent and purely expedient calculation, allowed only 44 percent of the total amount, claiming that the COLA roll-in should be an expense during only 44 percent of the test year.

The rejection of the Service's inclusion of this $220 million expense in the test year, and its reduction by $123 million to $97 million, is unsupported on the record and contrary to generally accepted accounting principles as correctly followed by the Postal Service. Proper accounting principles require a liability to be fully recognized at the time it is incurred.

The entire $219.8 million is an expense which accrues during the test year and must be met. Accordingly, its partial disallowance by the majority unlawfully increases the deficit between postal costs and revenues by $123 million.

F. Productivity

The majority has substituted its own methodology, developed on the basis of a Commission Notice of Inquiry issued 11 days after the close of the evidentiary record, for the Postal Service's computation of productivity.

I find the majority's conclusions as being insupportable, despite the fact that it refused to permit them to be examined and challenged on the evidentiary record with opportunity for cross-examination.

The evident frailty of the methodology utilized by the majority, as demonstrated by the Postal Service's January 5, 1981 response to the Commission's First Notice of Inquiry, establishes for me, even without reaching the significant due process arguments surrounding the manner in which it was developed, that the majority's test-year productivity conclusions, ostensibly arrived at through the utilization of the Taylor Series expansion and NERA methodology, are clearly unsupported by the record.

As demonstrated by the majority's own figures, the trend in productivity for the most recent period fails to support the projected productivity increase adopted by the majority. In fact, the majority's calculations, both by the Taylor Series and NERA method, show a productivity decrease of 2.71 and 2.78 percent for the most recent FY 1978 to FY 1979 period. Despite this trend in its own untested calculations, the majority optimistically projects a .5 percent productivity increase in order to attain a further $143 million cut in revenues.

The fact that serious unanswered discrepancies have surfaced in the Commission's untested approach, coupled with the result that the majority's calculated trend contradicts its own conclusions, clearly demonstrates that the majority cannot rationally substitute its assumptions for the record-tested conclusions presented by the Postal Service.

I find, therefore, that the majority has acted against the vast preponderance of record evidence in electing an intuitive and improbable productivity figure in order to reduce the revenue requirement a further $143 million. The result of its insupportable conclusion violates the break-even statutory provision by failing to provide sufficient revenues to meet the accrued test year costs established on this record.

IV. ASSIGNMENT, ATTRIBUTION AND ANALYSIS

A. Service-Related Costs

I personally remain unconvinced of the soundness of the Commission's service-related costing theory. Nevertheless, I must agree that my colleagues are essentially adhering to a procedure held permissible by the Court of Appeals in NAGCP III. Moreover, the Governors of the Postal Service in the recent Red-Tag proceeding (Docket No. MC79-3), while stating that "we do not intend to continue the concept of service-related costs as an element of postal rate determination," nonetheless adopted the Commission's rate recommendations which were premised on the service-related costing concept.[1/]

I dissented from the majority decision in Docket No. MC79-3 because there was no record evidence of a difference in attributable costs between red-tag and non-red-tag (ordinary) service. I could not then recommend a 2.3¢/piece rate differential between red-tag and non-red-tag service premised solely on an unrefined and theoretical service-related cost methodology in the absence of any concrete cost data which would support a rate differential. I still cannot do so.

1/ The Board of Governors did, however, defer the implementation of the Commission's recommended rates until June 1, 1981, thereby superseding them by rates to be recommended in Docket No. R80-1.

The record in the instant case fails to establish any attributable cost difference between red-tag (now called "expedited second-class mail") and non-red-tag mail. I cannot, therefore, recommend the rate differential proposed by the majority, which is still premised on an apparent extra-record belief that, despite the lack of any concrete cost data, a significant rate differential must be established because differing services are provided at uniform rates.

Although the inequity of the service-related cost concept does not fall with such abandon on those classes and subclasses of mail where the rate differentials are primarily incurred through verifiable attributable cost differences, and only secondarily on the theoretical basis of service-related costs, I still believe that the concept itself is too haphazard to be permanently adopted by the Commission. Its only saving grace appears to be that it increases the overall percentage of attributable and assignable costs to the 75% level achieved during the last rate proceeding. To me this is insufficient justification on which to base the rigid assignment of such significant costs.

I find, therefore, that the service-related cost concept is unreliable as a basis for accurately identifying cost incurrence and should be abandoned by the Commission.

B. Cost Segment Attribution Levels

I particularly disagree with the arbitrary attributions made by the majority in certain cost segments, specifically Cost Segment VII (City Delivery Carriers, Out-of-Office) which disregarded recently developed data results from the Household Mailstream Study[1]; Cost Segment X (Rural Carriers) which increased the Service's level of cost attribution despite the fact that the cost incurrences claimed have not been established by the record[2]; as well as the Cost Segment XIV (Purchased Transportation) modification made by the majority.

The increases in cost incurrence made by the majority were necessitated as much by the need to compensate for the shift of costs into first class due to the service-related costing approach it adopted, as it was by the desire to raise overall attributable and assignable costs to the 75% level.

1/ The majority has opted to ignore the further data contained in the Household Mailstream Study in order to increase its attribution levels premised on outdated information. This Commission should not have encouraged the Postal Service to spend millions of dollars on a long-range classification study program, only to disregard it when the data developed do not support the preconceived notions of the majority.

2/ The majority increased attribution for this cost segment by disregarding the Service's method-of-payment analysis, which is solidly based on the existing contractual agreement and factors which underlie that agreement. The factors which cause rural carrier cost incurrence necessarily flow from that contract and cannot be replaced by inapplicable data, including an irrelevant analogy to city delivery carriers.

This is borne out by the fact that the majority disturbed only 4 out of the Service's 22 cost segments which, coincidentally, comprise 60% of total cost segment accrued costs.[1/]

The rationale was developed to fit the result and, while meticulously derived, it should be re-examined in an atmosphere where rationalization is not forced by pre-determined conclusions prior to being adopted as an integral part of postal costing.

1/ The percentage attribution changes in the other cost segments result from the changes in these four segments.

CONCLUSIONS

I find the majority's actions in this case to mirror the discredited regulatory-activist policies of the past. It has acted to destroy the entity we were created to foster; shifted costs from the ratepayers onto the backs of the taxpayers; refused payment on $1 billion in expenses and then declared a profit; arrogantly broken the very statute which it accuses others of breaking; engaged in a regulatory shell game to conceal costs; and mortgaged our future for the fleeting publicity of today.

Despite its pretenses, the majority has accomplished very little, except to pass the buck -- all one billion bucks -- to the taxpayer and the next rate proceeding.

RECOMMENDATIONS

I find that the recommendations made by the majority are unsupported on the record and flawed in judgment. Its rates clearly fail to meet the requirement of the Postal Reorganization Act that recommended rates and fees should provide sufficient revenues to meet the Service's total estimated costs.

If adopted, the record establishes that the majority's rates can be expected to result in a revenue shortfall of over $1 billion during the test year.

I recommend, therefore, that the Governors consider, "under protest, [to] allow [the] recommended decision of the Commission to take effect and ... (2) return the recommended decision to the Commission for reconsideration and a further recommended decision." 39 U.S.C. §3625.

Such decisive action by the Governors will provide the Service with an increase in revenues during the interim period that is necessary to overturn the majority's act of regulatory irresponsibility, and will assure the eventual establishment of rates which provide "sufficient total revenues so that total estimated income and appropriations will equal as nearly as practicable estimated total costs."

James H. Duffy
Commissioner

Arpad de Kovacsy
Special Assistant

February 19, 1981
Washington, D.C.

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